

CITY OF PEQUOT LAKES, MINNESOTA

**FINANCIAL STATEMENTS AND
SUPPLEMENTARY INFORMATION**

YEAR ENDED DECEMBER 31, 2016

**CITY OF PEQUOT LAKES, MINNESOTA
TABLE OF CONTENTS
DECEMBER 31, 2016**

| | |
|---|-----------|
| INTRODUCTORY SECTION | |
| PRINCIPAL CITY OFFICIALS | 1 |
| FINANCIAL SECTION | |
| INDEPENDENT AUDITORS' REPORT | 2 |
| REQUIRED SUPPLEMENTARY INFORMATION | |
| MANAGEMENT'S DISCUSSION AND ANALYSIS | 5 |
| BASIC FINANCIAL STATEMENTS | |
| GOVERNMENT-WIDE FINANCIAL STATEMENTS | |
| STATEMENT OF NET POSITION | 16 |
| STATEMENT OF ACTIVITIES | 17 |
| FUND FINANCIAL STATEMENTS | |
| BALANCE SHEET – GOVERNMENTAL FUNDS | 19 |
| RECONCILIATION OF THE GOVERNMENTAL FUNDS BALANCE SHEET TO THE GOVERNMENT-WIDE STATEMENT OF NET POSITION – GOVERNMENTAL ACTIVITIES | 21 |
| STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES – GOVERNMENTAL FUNDS | 22 |
| RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES OF GOVERNMENTAL FUNDS TO THE GOVERNMENT-WIDE STATEMENT OF ACTIVITIES – GOVERNMENTAL ACTIVITIES | 24 |
| STATEMENT OF NET POSITION – PROPRIETARY FUNDS | 25 |
| STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION – PROPRIETARY FUNDS | 26 |
| STATEMENT OF CASH FLOWS – PROPRIETARY FUNDS | 27 |
| NOTES TO THE FINANCIAL STATEMENTS | 28 |

**CITY OF PEQUOT LAKES, MINNESOTA
TABLE OF CONTENTS (CONTINUED)
DECEMBER 31, 2016**

FINANCIAL SECTION (CONTINUED)

REQUIRED SUPPLEMENTARY INFORMATION OTHER THAN MD&A

| | |
|--|-----------|
| BUDGETARY COMPARISON SCHEDULE – GENERAL FUND | 66 |
| BUDGETARY COMPARISON SCHEDULE – FIRE DEPARTMENT SPECIAL REVENUE FUND | 68 |
| NOTES TO THE REQUIRED SUPPLEMENTARY INFORMATION | 69 |
| SCHEDULE OF FUNDING PROGRESS – OTHER POSTEMPLOYMENT BENEFITS | 70 |
| PEQUOT LAKES FIREMAN’S RELIEF ASSOCIATION – SCHEDULE OF CHANGES IN THE NET PENSION LIABILITY (ASSET) AND RELATED RATIOS | 71 |
| SCHEDULE OF THE CITY’S PROPORTIONATE SHARE OF THE NET PENSION LIABILITY (ASSET) | 72 |
| SCHEDULE OF CITY PENSION CONTRIBUTIONS | 73 |

SUPPLEMENTARY INFORMATION

| | |
|--|-----------|
| COMBINING BALANCE SHEET – NONMAJOR GOVERNMENTAL FUNDS | 74 |
| COMBINING STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES – NONMAJOR GOVERNMENTAL FUNDS | 76 |

REPORTS RELATED TO *GOVERNMENT AUDITING STANDARDS*

| | |
|--|-----------|
| INDEPENDENT AUDITORS’ REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH <i>GOVERNMENT AUDITING STANDARDS</i> | 78 |
| SCHEDULE OF FINDINGS AND RECOMMENDATIONS | 80 |
| INDEPENDENT AUDITORS’ REPORT ON MINNESOTA LEGAL COMPLIANCE | 82 |

INTRODUCTORY SECTION

**CITY OF PEQUOT LAKES, MINNESOTA
 PRINCIPAL CITY OFFICIALS
 DECEMBER 31, 2016**

| Position | Name | Term Expires |
|--------------------------|------------------------|-------------------|
| <u>Elected Officials</u> | | |
| Mayor | David Sjoblad | December 31, 2016 |
| Council Member | Jerry Akerson | December 31, 2018 |
| Council Member | Greg Karr | December 31, 2016 |
| Council Member | Scott Pederson | December 31, 2016 |
| Council Member | Randy Loukota | December 31, 2018 |
| <u>Appointed</u> | | |
| Administrator/Clerk | Nancy Malecha | |
| Attorney | Flaherty & Hood, P.A. | |
| Auditor | CliftonLarsonAllen LLP | |

This Page Has Been Intentionally Left Blank.

FINANCIAL SECTION

INDEPENDENT AUDITORS' REPORT

Honorable Mayor and
Members of the City Council
City of Pequot Lakes
Pequot Lakes, Minnesota

Report on the Financial Statements

We have audited the accompanying financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Pequot Lakes (the City), Minnesota, as of and for the year ended December 31, 2016, and the related notes to the financial statements, which collectively comprise the City's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express opinions on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the City's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City, as of December 31, 2016, the respective changes in financial position and, where applicable, its cash flows, for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis, budgetary comparison information, schedule of funding progress, and the pension schedules as listed in the table of contents, respectively, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Supplementary Information

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the City's basic financial statements. The combining nonmajor fund financial statements are presented for purposes of additional analysis and are not a required part of the basic financial statements.

The combining nonmajor fund financial statements are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

Honorable Mayor and
Members of the City Council
City of Pequot Lakes

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated April 21, 2017, on our consideration of the City's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the City's internal control over financial reporting and compliance.



CliftonLarsonAllen LLP

Brainerd, Minnesota
April 21, 2017

This Page Has Been Intentionally Left Blank.

REQUIRED SUPPLEMENTARY INFORMATION

**CITY OF PEQUOT LAKES, MINNESOTA
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED DECEMBER 31, 2016**

This section of the annual financial report of the City of Pequot Lakes (the City) presents our discussion and analysis of the City's financial performance during the fiscal year that ended on December 31, 2016. The Management's Discussion and Analysis (MD&A) is an element of Required Supplementary Information specified in Governmental Accounting Standard Board (GASB) Statement No. 34 – *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*. Certain comparative information between the current year, 2016, and the prior year, 2015, is required to be presented in the MD&A.

FINANCIAL HIGHLIGHTS

Key financial highlights for 2016 include the following:

- ◆ City-wide net position increased 6% over the prior year. The primary reason for the increase is due to an increase in taxes and miscellaneous revenues.
- ◆ Overall, governmental fund-level revenues totaled \$2,395,566 and were \$97,194 less than expenditures before other financing sources. This excess of expenditures over revenues is due to capital outlay projects/purchases.
- ◆ The General Fund's fund balance increased \$6,867 (0.5%) from the prior year due mainly to proceeds from the sale of assets.
- ◆ The Fire Department Fund's fund balance increased \$20,111 (28%) from the prior year due mainly to an increase in charges for services and miscellaneous revenues.
- ◆ The Highway 371 Project Fund's fund balance decreased \$111,912 (67%) from the prior year due to an increase in capital outlay.
- ◆ The Sewer Enterprise Fund's net position increased \$674,037 (40%) from the prior year due to an increase in intergovernmental revenues.

OVERVIEW OF THE FINANCIAL STATEMENTS

The financial section of the annual report consists of four parts – Independent Auditors' Report, required supplementary information which includes the management's discussion and analysis (this section), the basic financial statements, and supplementary information. The basic financial statements include two kinds of statements that present different views of the City:

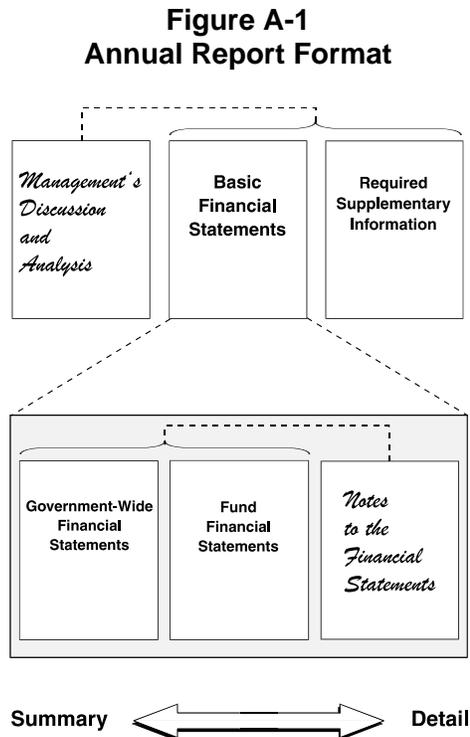
- ◆ The first two statements are City-wide financial statements which provide both short-term and long-term information about the City's overall financial status.
- ◆ The remaining statements are fund financial statements which focus on individual parts of the City, reporting the City's operations in more detail than the City-wide statements.
 - The governmental funds statements tell how basic services such as general government, public safety, and highways and streets were financed in the short term, as well as what remains for future spending.

**CITY OF PEQUOT LAKES, MINNESOTA
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED DECEMBER 31, 2016**

OVERVIEW OF THE FINANCIAL STATEMENTS (CONTINUED)

The financial statements also include notes that explain some of the information in the statements and provide more detailed data.

Figure A-1 shows how the various parts of this annual report are arranged and related to one another.



**CITY OF PEQUOT LAKES, MINNESOTA
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED DECEMBER 31, 2016**

OVERVIEW OF THE FINANCIAL STATEMENTS (CONTINUED)

Figure A-2 summarizes the major features of the City's financial statements, including the portion of the City's activities they cover and the types of information they contain. The remainder of this overview section of management's discussion and analysis highlights the structure and contents of each of the statements.

**Figure A-2
Major Features of the City's Financial Statements**

| Type of Statements | Government-Wide | Governmental Funds | Proprietary Funds |
|--|---|---|---|
| Scope | Entire City's government (except fiduciary funds). | The activities of the City that are not proprietary or fiduciary. | The activities of the City that operate similar to private businesses: water and sewer. |
| Required Financial Statements | Statement of net position. | Balance sheet. | Statement of net position. |
| | Statement of activities. | Statement of revenues, expenditures and changes in fund balance. | Statement of revenues, expenses, and changes in net position and statement of cash flows. |
| Accounting Basis and Measurement Focus | Accrual accounting and economic resources focus. | Modified accrual accounting and current financial resources focus. | Accrual accounting and economic resources focus. |
| Type of Asset and Deferred Outflow of Resources /Liability and Deferred Inflow of Resources Information | All assets and liabilities, both financial and capital, short-term and long-term. | Only assets and deferred outflows of resources expected to be used up and liabilities and deferred inflows of resources that came due during the year or soon thereafter, no capital assets included. | All assets and liabilities, both financial and capital, and short-term and long-term. |
| Type of Inflow/Outflow Information | All revenues and expenses during year, regardless of when cash is received or paid. | Revenues for which cash is received during or soon after the end of the year, expenditures when goods or services have been received and payment is due during the year or soon thereafter. | All revenues and expenses during the year, regardless of when cash is received or paid. |

City-Wide Statements

The City-wide statements report information about the City as a whole using accounting methods similar to those used by private-sector companies. The statement of net position includes all of the City's assets, deferred inflows of resources, deferred outflows of resources, and liabilities. All of the current year's revenues and expenses are accounted for in the statement of activities regardless of when cash is received or paid.

**CITY OF PEQUOT LAKES, MINNESOTA
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED DECEMBER 31, 2016**

OVERVIEW OF THE FINANCIAL STATEMENTS (CONTINUED)

City-Wide Statements (Continued)

The two City-wide statements report the City's net position and how they have changed. Net position – the difference between the City's assets, deferred outflows, deferred inflows and liabilities – is one way to measure the City's financial health or position.

- ◆ Over time, increases or decreases in the City's net position are an indicator of whether its financial position is improving or deteriorating, respectively.
- ◆ To assess the overall health of the City, you need to consider additional non-financial factors such as changes in the City's property tax base and the condition of City buildings and other facilities.

In the City-wide financial statements the City's activities are shown in two categories:

- ◆ Governmental activities – The City's basic services are included here. Property taxes, special assessments, and state aid finance most of these activities.
- ◆ Business-type activities – The City's enterprise fund operations are included here. Charges for services finance most of these activities.

Fund Financial Statements

The fund financial statements provide more detailed information about the City's funds – focusing on its most significant or "major" funds – not the City as a whole. Funds are accounting devices the City uses to keep track of specific sources of funding and spending on particular programs:

- ◆ Some funds are required by state law and by bond covenants.
- ◆ The City establishes other funds to control and manage money for particular purposes (e.g., repaying its long-term debts) or to show that it is properly using certain revenues (e.g., federal grants).

The City has two kinds of funds:

- ◆ Governmental funds – The City's basic services are included in governmental funds, which generally focus on (1) how cash and other financial assets that can readily be converted to cash flow in and out and (2) the balances left at year-end that are available for spending. Consequently, the governmental funds statements provide a detailed short-term view that helps to determine whether there are more or fewer financial resources that can be spent in the near future to finance the City's programs. Because this information does not encompass the additional long-term focus of the City-wide statements, we provide additional information after the governmental funds statements that explain the relationship (or differences) between them.
- ◆ Proprietary funds – The City reports two proprietary funds. Enterprise funds are used to report the same functions presented as business-type activities in the government-wide financial statements. The City uses enterprise funds to account for its water and sewer utilities. Proprietary fund financial statements provide the same type of information as the government-wide financial statements, only in more detail.

**CITY OF PEQUOT LAKES, MINNESOTA
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED DECEMBER 31, 2016**

FINANCIAL ANALYSIS OF THE CITY AS A WHOLE

Net Position

The City's total net position was \$11,354,863 on December 31, 2016 (see Table A-1).

**Table A-1
The City's Net Position**

| | Governmental Activities | | Business-Type Activities | | Total | |
|----------------------------------|-------------------------|---------------------|--------------------------|---------------------|----------------------|----------------------|
| | 2016 | 2015 | 2016 | 2015 | 2016 | 2015 |
| Current and Other Assets | \$ 2,248,173 | \$ 2,348,743 | \$ 1,541,599 | \$ 1,748,758 | \$ 3,789,772 | \$ 4,097,501 |
| Capital and Noncurrent Assets | 7,637,945 | 7,555,580 | 2,909,920 | 2,007,455 | 10,547,865 | 9,563,035 |
| Total Assets | <u>9,886,118</u> | <u>9,904,323</u> | <u>4,451,519</u> | <u>3,756,213</u> | <u>14,337,637</u> | <u>13,660,536</u> |
| Deferred Outflows of Resources | 1,157,415 | 185,923 | 10,338 | 3,466 | 1,167,753 | 189,389 |
| Current Liabilities | 216,425 | 218,719 | 182,170 | 178,330 | 398,595 | 397,049 |
| Long-Term Liabilities | 2,497,125 | 1,502,574 | 1,022,519 | 1,083,691 | 3,519,644 | 2,586,265 |
| Total Liabilities | <u>2,713,550</u> | <u>1,721,293</u> | <u>1,204,689</u> | <u>1,262,021</u> | <u>3,918,239</u> | <u>2,983,314</u> |
| Deferred Inflows of Resources | 227,798 | 119,197 | 4,490 | 4,288 | 232,288 | 123,485 |
| Net Position | | | | | | |
| Net Investment in Capital Assets | 6,652,223 | 6,441,610 | 1,875,614 | 912,551 | 8,527,837 | 7,354,161 |
| Restricted | 213,141 | 244,159 | - | - | 213,141 | 244,159 |
| Unrestricted | 1,236,821 | 1,563,987 | 1,377,064 | 1,580,819 | 2,613,885 | 3,144,806 |
| Total Net Position | <u>\$ 8,102,185</u> | <u>\$ 8,249,756</u> | <u>\$ 3,252,678</u> | <u>\$ 2,493,370</u> | <u>\$ 11,354,863</u> | <u>\$ 10,743,126</u> |

**CITY OF PEQUOT LAKES, MINNESOTA
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED DECEMBER 31, 2016**

FINANCIAL ANALYSIS OF THE CITY AS A WHOLE (CONTINUED)

Changes in Net Position

The City-wide total revenues were \$3,482,123 the year ended December 31, 2016. Property taxes and intergovernmental revenues accounted for 69% of total revenue for the year (see Table A-2).

**Table A-2
Change in Net Position**

| | Governmental Activities | | Total % Change | Business-Type Activities | | Total % Change | Total | | Total % Change |
|------------------------------------|----------------------------|---------------------|-------------------|-----------------------------|---------------------|-------------------|----------------------|----------------------|-------------------|
| | 2016 | 2015 | | 2016 | 2015 | | 2016 | 2015 | |
| REVENUES | | | | | | | | | |
| <u>Program Revenues</u> | | | | | | | | | |
| Charges for Services | \$ 359,456 | \$ 334,559 | 7.4 % | \$ 563,598 | \$ 544,862 | 3.4 % | \$ 923,054 | \$ 879,421 | 5.0 % |
| Operating Grants and Contributions | 211,402 | 195,085 | 8.4 | - | - | - | 211,402 | 195,085 | 8.4 |
| Capital Grants and Contributions | 71 | 58,592 | (99.9) | 506,000 | - | 100.0 | 506,071 | 58,592 | 763.7 |
| <u>General Revenues</u> | | | | | | | | | |
| Property Taxes | 1,644,246 | 1,617,774 | 1.6 | - | - | - | 1,644,246 | 1,617,774 | 1.6 |
| Unrestricted State Aid | 37,101 | 57,923 | (35.9) | - | - | - | 37,101 | 57,923 | (35.9) |
| Investment Earnings | 15,497 | 20,099 | (22.9) | 11,013 | 13,768 | (20.0) | 26,510 | 33,867 | (21.7) |
| Other | 133,739 | 87,359 | 53.1 | - | - | - | 133,739 | 87,359 | 53.1 |
| Total Revenues | 2,401,512 | 2,371,391 | 1.3 | 1,080,611 | 558,630 | 93.4 | 3,482,123 | 2,930,021 | 18.8 |
| EXPENSES | | | | | | | | | |
| General Government | 559,883 | 554,031 | 1.1 | - | - | - | 559,883 | 554,031 | 1.1 |
| Public Safety | 1,197,962 | 949,877 | 26.1 | - | - | - | 1,197,962 | 949,877 | 26.1 |
| Highways and Streets | 611,412 | 549,962 | 11.2 | - | - | - | 611,412 | 549,962 | 11.2 |
| Sanitation | 9,468 | 8,971 | 5.5 | - | - | - | 9,468 | 8,971 | 5.5 |
| Water | - | - | - | 196,123 | 224,542 | (12.7) | 196,123 | 224,542 | (12.7) |
| Sewer | - | - | - | 125,180 | 124,832 | 0.3 | 125,180 | 124,832 | 0.3 |
| Culture and Recreation | 70,229 | 49,984 | 40.5 | - | - | - | 70,229 | 49,984 | 40.5 |
| Economic Development | 79,063 | 113,804 | (30.5) | - | - | - | 79,063 | 113,804 | (30.5) |
| Interest | 21,066 | 23,814 | (11.5) | - | - | - | 21,066 | 23,814 | (11.5) |
| Total Expenses | 2,549,083 | 2,250,443 | 13.3 | 321,303 | 349,374 | (8.0) | 2,870,386 | 2,599,817 | 10.4 |
| CHANGE IN NET POSITION | (147,571) | 120,948 | (222.0) | 759,308 | 209,256 | 262.9 | 611,737 | 330,204 | 85.3 |
| Net Position - Beginning of Year | 8,249,756 | 8,128,808 | | 2,493,370 | 2,284,114 | | 10,743,126 | 10,412,922 | |
| NET POSITION - END OF YEAR | <u>\$ 8,102,185</u> | <u>\$ 8,249,756</u> | | <u>\$ 3,252,678</u> | <u>\$ 2,493,370</u> | | <u>\$ 11,354,863</u> | <u>\$ 10,743,126</u> | |

Total revenues surpassed expenses, increasing net position \$611,737 over last year.

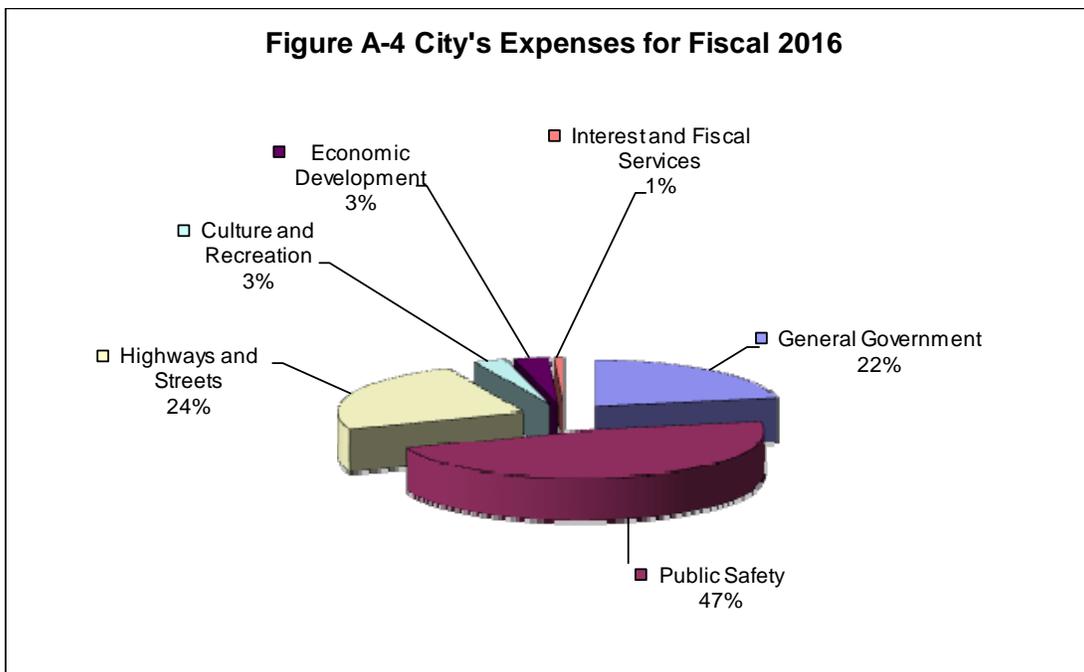
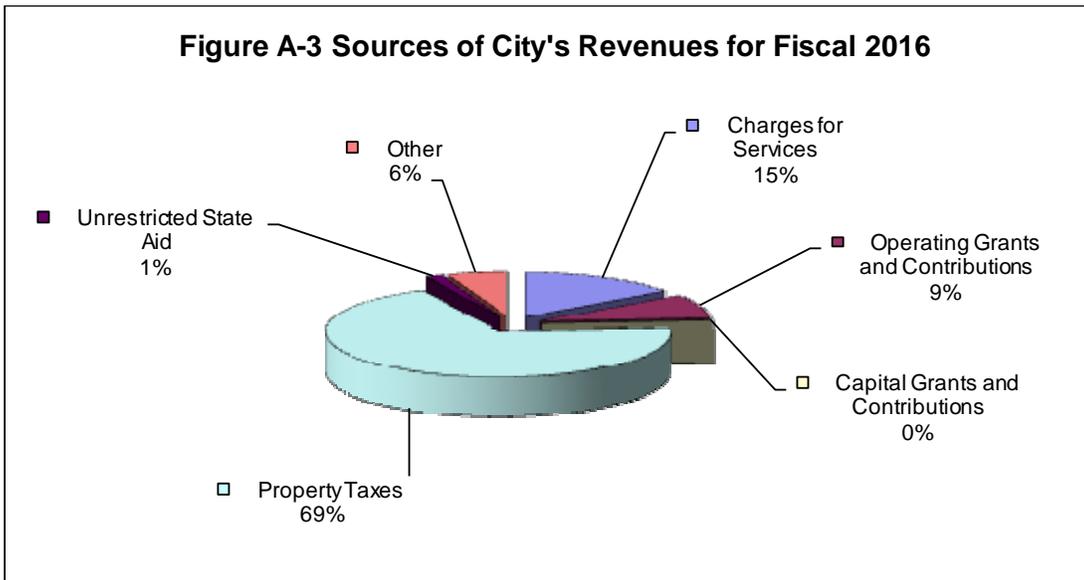
**CITY OF PEQUOT LAKES, MINNESOTA
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED DECEMBER 31, 2016**

FINANCIAL ANALYSIS OF THE CITY AS A WHOLE (CONTINUED)

Changes in Net Position (Continued)

The City-wide cost of all governmental activities this year was \$2,549,083.

- ◆ Some of the cost was paid by the users of the City's programs \$359,456.
- ◆ The federal and state governments subsidized certain programs with grants and contributions \$211,473.
- ◆ The remainder of the City's governmental activities costs of \$1,978,154, however, was paid for by City taxpayers, the taxpayers of Minnesota, and other miscellaneous revenues.



This Page Has Been Intentionally Left Blank.

**CITY OF PEQUOT LAKES, MINNESOTA
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED DECEMBER 31, 2016**

FINANCIAL ANALYSIS OF THE CITY AS A WHOLE (CONTINUED)

Changes in Net Position (Continued)

**Table A-3
Total and Net Cost of Services**

| | Total Cost of Services | | Percentage Change | Net (Revenue) Cost of Providing Services | | Percentage Change |
|---------------------------------|------------------------|---------------------|----------------------|---|---------------------|----------------------|
| | 2016 | 2015 | | 2016 | 2015 | |
| GOVERNMENTAL ACTIVITIES | | | | | | |
| General Government | \$ 559,883 | \$ 554,031 | 1.1 % | \$ 523,018 | \$ 519,375 | 0.7 % |
| Public Safety | 1,197,962 | 949,877 | 26.1 | 766,427 | 543,994 | 40.9 |
| Highways and Streets | 611,412 | 549,962 | 11.2 | 611,341 | 491,370 | 24.4 |
| Sanitation | 9,468 | 8,971 | 5.5 | (2,619) | (1,628) | (60.9) |
| Culture and Recreation | 70,229 | 49,984 | 40.5 | (20,142) | (28,522) | 29.4 |
| Economic Development | 79,063 | 113,804 | (30.5) | 79,063 | 113,804 | (30.5) |
| Interest | 21,066 | 23,814 | (11.5) | 21,066 | 23,814 | (11.5) |
| Total | <u>\$ 2,549,083</u> | <u>\$ 2,250,443</u> | 13.3 | <u>\$ 1,978,154</u> | <u>\$ 1,662,207</u> | 19.0 |
| BUSINESS-TYPE ACTIVITIES | | | | | | |
| Water | \$ 196,123 | \$ 224,542 | (12.7)% | \$ (83,150) | \$ (44,067) | (88.7)% |
| Sewer | 125,180 | 124,832 | 0.3 | (665,145) | (151,421) | (339.3) |
| Total | <u>\$ 321,303</u> | <u>\$ 349,374</u> | (8.0) | <u>\$ (748,295)</u> | <u>\$ (195,488)</u> | (282.8) |

FINANCIAL ANALYSIS OF THE CITY AT THE FUND LEVEL

The financial performance of the City is reflected in its governmental funds as well. As the City completed the year, its governmental funds reported a combined fund balance of \$1,990,415.

Revenues for the City's governmental funds were \$2,395,566, while total expenditures were \$2,492,760.

The General Fund's fund balance increased \$6,867 from the prior year. This is due primarily to an increase in tax and intergovernmental revenues.

The Fire Department Fund's fund balance increased \$20,211 from the prior year, due primarily to an increase in charges for services and miscellaneous revenues.

The Business Park Fund's fund balance increased \$1,407 from the prior year due to minimal business park expenditures.

The Highway 371 Project Fund's fund balance decreased \$111,912 from the prior year due to increased capital outlay expenditures on the project.

**CITY OF PEQUOT LAKES, MINNESOTA
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED DECEMBER 31, 2016**

FINANCIAL ANALYSIS OF THE CITY AT THE FUND LEVEL (CONTINUED)

The Water Enterprise Fund's net position increased \$85,271 from the prior year. This is due to an increase in charges for services.

The Sewer Enterprise Fund's net position increased \$674,037. This is due to an increase in intergovernmental revenues.

GENERAL FUND

The following schedule presents a summary of General Fund Revenues:

**Table A-4
General Fund Revenues**

| | Year Ended | | Change | |
|----------------------------|----------------------|----------------------|------------------------|---------|
| | December 31, 2016 | December 31, 2015 | Increase (Decrease) | Percent |
| Taxes and Specials | \$ 1,563,986 | \$ 1,494,805 | \$ 69,181 | 4.6 % |
| Intergovernmental | 101,347 | 167,240 | (65,893) | (39.4) |
| Charges for Services | 128,463 | 121,332 | 7,131 | 5.9 |
| Interest | 11,263 | 12,655 | (1,392) | (11.0) |
| Miscellaneous | 166,619 | 171,530 | (4,911) | (2.9) |
| Total General Fund Revenue | <u>\$ 1,971,678</u> | <u>\$ 1,967,562</u> | <u>\$ 4,116</u> | 0.2 |

Total General Fund revenue increased by \$4,116, or (0.2%), from the previous year. This is due primarily to increased taxes.

The following schedule presents a summary of General Fund Expenditures:

**Table A-5
General Fund Expenditures**

| | Year Ended | | Change | |
|------------------------|----------------------|----------------------|------------------------|---------|
| | December 31, 2016 | December 31, 2015 | Increase (Decrease) | Percent |
| General Government | \$ 479,915 | \$ 477,204 | \$ 2,711 | 0.6 % |
| Public Safety | 779,008 | 802,297 | (23,289) | (2.9) |
| Highways and Streets | 531,227 | 494,839 | 36,388 | 7.4 |
| Sanitation | 9,468 | 8,971 | 497 | 5.5 |
| Culture and Recreation | 101,537 | 58,097 | 43,440 | 74.8 |
| Economic Development | 48,490 | 45,805 | 2,685 | 5.9 |
| Debt Service | 32,010 | 32,010 | - | - |
| Total Expenditures | <u>\$ 1,981,655</u> | <u>\$ 1,919,223</u> | <u>\$ 62,432</u> | 3.3 |

**CITY OF PEQUOT LAKES, MINNESOTA
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED DECEMBER 31, 2016**

GENERAL FUND (CONTINUED)

General Fund Budgetary Highlights

Over the course of the year, the City did not revise the annual operating budget. Historically, the City has not made budget amendments during the year.

- ◆ Actual revenues were \$167,791 more than expected due to an increase in gifts and contributions, miscellaneous revenues, and taxes.
- ◆ The actual expenditures were \$119,068 over budgeted expenditures due to higher capital outlay expenditures than anticipated.

CONSTRUCTION PROJECTS AND DEBT SERVICE

Tax revenues and charges for utility services are used to fund the bond payments for all previous bond issues. The City completed a large infrastructure project in the Sewer Fund in 2016.

CAPITAL ASSETS

By the end of 2016, the City had invested approximately \$18,000,000 in a broad range of capital assets, including buildings, computers, improvements, equipment, and infrastructure. (See Table A-6). (More detailed information about capital assets can be found in Note 3.A.3 to the financial statements.) Total depreciation expense for the year was \$507,115 (including the enterprise funds).

**Table A-6
The City's Capital Assets**

| | Governmental Activities | | Percent Change | Business-Type Activities | | Percent Change | Total | | Percent Change |
|------------------------------------|----------------------------|---------------------|-------------------|-----------------------------|---------------------|-------------------|----------------------|---------------------|-------------------|
| | 2016 | 2015 | | 2016 | 2015 | | 2016 | 2015 | |
| Land | \$ 1,504,339 | \$ 1,504,339 | - % | \$ 178,167 | \$ 178,167 | - % | \$ 1,682,506 | \$ 1,682,506 | - % |
| Construction-in-Progress | 81,593 | 86,051 | (5.2) | - | 96,047 | (100.0) | 81,593 | 182,098 | (55.2) |
| Infrastructure | 5,988,353 | 5,778,773 | 3.6 | 1,483,394 | 427,071 | 247.3 | 7,471,747 | 6,205,844 | 20.4 |
| Buildings | 1,549,150 | 1,536,861 | 0.8 | 1,125,329 | 1,125,329 | - | 2,674,479 | 2,662,190 | 0.5 |
| Machinery, Equipment, and Vehicles | 2,938,297 | 2,694,578 | 9.0 | 3,186,408 | 3,153,838 | 1.0 | 6,124,705 | 5,848,416 | 4.7 |
| Less: Accumulated Depreciation | (4,760,537) | (4,427,314) | 7.5 | (3,063,378) | (2,972,997) | 3.0 | (7,823,915) | (7,400,311) | 5.7 |
| Total | \$ 7,301,195 | \$ 7,173,288 | 1.8 | \$ 2,909,920 | \$ 2,007,455 | 45.0 | \$ 10,211,115 | \$ 9,180,743 | 11.2 |

**CITY OF PEQUOT LAKES, MINNESOTA
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED DECEMBER 31, 2016**

LONG-TERM LIABILITIES

At year-end, the City had \$1,683,278 (net of related discounts and premiums) in long-term liabilities outstanding.

- ◆ The City's governmental activities total long-term debt decreased \$82,706 due primarily to the repayment of equipment certificates, capital leases, and loans payable. The City's business-type activities total long-term debt decreased \$60,598 due primarily to the repayment of general obligation bonds. Additional information on the City's long-term liabilities can be found in Note 3.C.1.

**Table A-7
The City's Long-Term Liabilities**

| | 2016 | 2015 | Percentage Change |
|---------------------------------|---------------------|---------------------|----------------------|
| GOVERNMENTAL ACTIVITIES | | | |
| Equipment Certificates | \$ 118,000 | \$ 156,000 | (24.4)% |
| Capital Leases | 217,889 | 243,819 | (10.6) |
| Loans Payable | 313,083 | 331,859 | (5.7) |
| Total | <u>\$ 648,972</u> | <u>\$ 731,678</u> | (11.3) |
| BUSINESS-TYPE ACTIVITIES | | | |
| General Obligation Bonds | \$ 1,031,862 | \$ 1,091,986 | (5.5)% |
| Capital Leases | 2,444 | 2,918 | (16.2) |
| Total | <u>\$ 1,034,306</u> | <u>\$ 1,094,904</u> | (5.5) |

FACTORS BEARING ON THE CITY'S FUTURE

Highway 371 Expansion

The Highway 371 Expansion project will continue in 2017. When this project is complete in 2018, County Road 11 will become a major corridor entrance to the City and several miles of road turnbacks will be acquired by the City.

CONTACTING THE CITY'S FINANCIAL MANAGEMENT

This financial report is designed to provide our citizens, taxpayers, customers, investors, and creditors with a general overview of the City's finances and to demonstrate the City's accountability for the money it receives. If you have questions about this report or need additional financial information, contact Nancy Malecha, City Administrator/Clerk at (218) 568-5222.

BASIC FINANCIAL STATEMENTS

GOVERNMENT-WIDE FINANCIAL STATEMENTS

CITY OF PEQUOT LAKES, MINNESOTA
STATEMENT OF NET POSITION
DECEMBER 31, 2016

| | Governmental Activities | Business-Type Activities | Total |
|--|----------------------------|-----------------------------|----------------------|
| ASSETS | | | |
| Cash and Investments | \$ 1,973,371 | \$ 1,400,787 | \$ 3,374,158 |
| Petty Cash and Change Funds | 942 | - | 942 |
| Taxes Receivable | | | |
| Unapportioned | 65,867 | - | 65,867 |
| Delinquent | 145,211 | - | 145,211 |
| Special Assessments Receivable | | | |
| Delinquent | 12,803 | - | 12,803 |
| Noncurrent | - | 3,699 | 3,699 |
| Accounts Receivable, Net of Allowance | 4,234 | 137,113 | 141,347 |
| Accrued Interest Receivable | 94 | - | 94 |
| Due from Other Governments | 1,331 | - | 1,331 |
| Debt Reserve Restricted Cash | 8,358 | - | 8,358 |
| Loans Receivable | 10,178 | - | 10,178 |
| Land Held for Resale | 25,784 | - | 25,784 |
| Net Pension Asset | 336,750 | - | 336,750 |
| Capital Assets not Being Depreciated | | | |
| Land | 1,504,339 | 178,167 | 1,682,506 |
| Construction in Progress | 81,593 | - | 81,593 |
| Capital Assets Being Depreciated | | | |
| Building (Net) | 903,595 | 60,759 | 964,354 |
| Machinery, Vehicles, Furniture, and Equipment (Net) | 1,413,378 | 1,316,824 | 2,730,202 |
| Infrastructure (Net) | 3,398,290 | 1,354,170 | 4,752,460 |
| Total Assets | 9,886,118 | 4,451,519 | 14,337,637 |
| DEFERRED OUTFLOWS OF RESOURCES | | | |
| Pension Related | 1,157,415 | 10,338 | 1,167,753 |
| LIABILITIES | | | |
| Accounts Payable | 73,382 | 109,382 | 182,764 |
| Salaries Payable | 25,392 | 1,274 | 26,666 |
| Due to Other Governments | 1,157 | 98 | 1,255 |
| Accrued Interest Payable | 10,151 | 10,104 | 20,255 |
| Compensated Absences Payable - Due Within One Year | 20,877 | 788 | 21,665 |
| Loans Payable - Due Within One Year | 19,433 | - | 19,433 |
| General Obligation Refunding Bonds Payable - Due Within One Year | - | 60,000 | 60,000 |
| Equipment Certificates - Due Within One Year | 38,750 | - | 38,750 |
| Capital Leases Payable - Due Within One Year | 27,283 | 524 | 27,807 |
| Compensated Absences Payable - Due in More than One Year | 25,656 | 1,884 | 27,540 |
| Loans Payable - Due in More than One Year | 293,650 | - | 293,650 |
| General Obligation Refunding Bonds Payable - Due in More than One Year | - | 971,862 | 971,862 |
| Equipment Certificates - Due in More than One Year | 79,250 | - | 79,250 |
| Capital Leases Payable - Due in More than One Year | 190,606 | 1,920 | 192,526 |
| Net Pension Liability - Due in More than One Year | 1,742,072 | 28,848 | 1,770,920 |
| Other Postemployment Benefits Payable - Due in More than One Year | 165,891 | 18,005 | 183,896 |
| Total Liabilities | 2,713,550 | 1,204,689 | 3,918,239 |
| DEFERRED INFLOWS OF RESOURCES | | | |
| Pension Related | 227,798 | 4,490 | 232,288 |
| NET POSITION | | | |
| Net Investment in Capital Assets | 6,652,223 | 1,875,614 | 8,527,837 |
| Restricted for Library | 67,303 | - | 67,303 |
| Restricted for Park Dedication | 24,802 | - | 24,802 |
| Restricted by Donor - Splash Park | 15,000 | - | 15,000 |
| Restricted for Debt Service Reserves | 8,358 | - | 8,358 |
| Restricted for Loans Receivable | 53,744 | - | 53,744 |
| Restricted for Economic Development | 117 | - | 117 |
| Restricted for Debt Service | 43,817 | - | 43,817 |
| Unrestricted | 1,236,821 | 1,377,064 | 2,613,885 |
| Total Net Position | \$ 8,102,185 | \$ 3,252,678 | \$ 11,354,863 |

See accompanying Notes to Financial Statements.

**CITY OF PEQUOT LAKES, MINNESOTA
STATEMENT OF ACTIVITIES
YEAR ENDED DECEMBER 31, 2016**

| Functions/Programs | Expenses | Program Revenues | | |
|--------------------------------|--------------|------------------------------------|--|--|
| | | Fees, Charges, Fines, and Other | Operating Grants and Contributions | Capital Grants and Contributions |
| Primary Government | | | | |
| Governmental Activities | | | | |
| General Government | \$ 559,883 | \$ 32,871 | \$ 3,994 | \$ - |
| Public Safety | 1,197,962 | 301,334 | 130,201 | - |
| Highways and Streets | 611,412 | - | - | 71 |
| Sanitation | 9,468 | 362 | 11,725 | - |
| Culture and Recreation | 70,229 | 24,889 | 65,482 | - |
| Economic Development | 79,063 | - | - | - |
| Interest | 21,066 | - | - | - |
| Total Governmental Activities | 2,549,083 | 359,456 | 211,402 | 71 |
| Business-Type Activities | | | | |
| Water | 196,123 | 279,273 | - | - |
| Sewer | 125,180 | 284,325 | - | 506,000 |
| Total Business-Type Activities | 321,303 | 563,598 | - | 506,000 |
| Total Primary Government | \$ 2,870,386 | \$ 923,054 | \$ 211,402 | \$ 506,071 |

General Revenues

Property Taxes

Grants and Contributions not Restricted for a Particular Purpose

Investment Earnings

Miscellaneous

Gain on Sale of Capital Assets

Total General Revenues

CHANGE IN NET POSITION

Net Position - Beginning of Year

NET POSITION - END OF YEAR

Net (Expense) Revenue and
Changes in Net Position

| Governmental Activities | Business-Type Activities | Total |
|----------------------------|-----------------------------|---------------|
| \$ (523,018) | \$ - | \$ (523,018) |
| (766,427) | - | (766,427) |
| (611,341) | - | (611,341) |
| 2,619 | - | 2,619 |
| 20,142 | - | 20,142 |
| (79,063) | - | (79,063) |
| (21,066) | - | (21,066) |
| (1,978,154) | - | (1,978,154) |
| - | 83,150 | 83,150 |
| - | 665,145 | 665,145 |
| - | 748,295 | 748,295 |
| (1,978,154) | 748,295 | (1,229,859) |
| 1,644,246 | - | 1,644,246 |
| 37,101 | - | 37,101 |
| 15,497 | 11,013 | 26,510 |
| 114,194 | - | 114,194 |
| 19,545 | - | 19,545 |
| 1,830,583 | 11,013 | 1,841,596 |
| (147,571) | 759,308 | 611,737 |
| 8,249,756 | 2,493,370 | 10,743,126 |
| \$ 8,102,185 | \$ 3,252,678 | \$ 11,354,863 |

This Page Has Been Intentionally Left Blank.

FUND FINANCIAL STATEMENTS

**CITY OF PEQUOT LAKES, MINNESOTA
BALANCE SHEET
GOVERNMENTAL FUNDS
DECEMBER 31, 2016**

| | Major Funds | |
|---|---------------------|--------------------|
| | General | Fire Department |
| ASSETS | | |
| Cash and Investments | \$ 1,390,939 | \$ 87,210 |
| Petty Cash and Change Funds | 942 | - |
| Taxes Receivable | | |
| Current | 53,584 | - |
| Noncurrent | 145,211 | - |
| Special Assessments Receivable | | |
| Delinquent | 12,803 | - |
| Accounts Receivable, Net of Allowance | 2,814 | 1,420 |
| Accrued Interest Receivable | 94 | - |
| Due from Other Governments | 1,331 | - |
| Due from Other Funds | - | - |
| Debt Reserve Restricted Cash | - | 8,358 |
| Land Held for Resale | - | - |
| Loans Receivable | - | - |
| Total Assets | <u>\$ 1,607,718</u> | <u>\$ 96,988</u> |
| LIABILITIES, DEFERRED INFLOWS OF RESOURCES, AND FUND BALANCES | | |
| LIABILITIES | | |
| Accounts Payable | \$ 54,710 | \$ 4,139 |
| Due to Other Governments | 1,157 | - |
| Salaries Payable | 25,392 | - |
| Due to Other Funds | - | - |
| Total Liabilities | <u>81,259</u> | <u>4,139</u> |
| DEFERRED INFLOWS OF RESOURCES | | |
| Unavailable for Special Assessments | 12,616 | - |
| Unavailable for Taxes | 145,211 | - |
| Total Deferred Inflows of Resources | <u>157,827</u> | <u>-</u> |
| FUND BALANCES (DEFICITS) | | |
| Nonspendable | - | - |
| Restricted for Park Dedication | 24,802 | - |
| Restricted by Donor - Splash Park | 15,000 | - |
| Restricted for Debt Service Reserves | - | 8,358 |
| Restricted for Loans Receivable | - | - |
| Restricted for Other Governmental Funds | - | - |
| Restricted for Library | 67,303 | - |
| Committed for Library | 107,753 | - |
| Committed for Capital Outlay | 66,985 | 12,000 |
| Committed for Fire Protection Services | - | 72,491 |
| Committed for Business Park | - | - |
| Committed for Other Governmental Funds | - | - |
| Committed for Highway 371 Project | - | - |
| Unassigned | 1,086,789 | - |
| Total Fund Balances (Deficits) | <u>1,368,632</u> | <u>92,849</u> |
| Total Liabilities, Deferred Inflows of Resources, and Fund Balances (Deficits) | <u>\$ 1,607,718</u> | <u>\$ 96,988</u> |

See accompanying Notes to Financial Statements.

| Business Park | Highway 371 Project | Other Governmental Funds | Total Governmental Funds |
|-------------------|---------------------|--------------------------|--------------------------|
| \$ 339,928 | \$ 45,900 | \$ 109,394 | \$ 1,973,371 |
| - | - | - | 942 |
| - | 10,500 | 1,783 | 65,867 |
| - | - | - | 145,211 |
| - | - | - | 12,803 |
| - | - | - | 4,234 |
| - | - | - | 94 |
| - | - | - | 1,331 |
| 43,566 | - | - | 43,566 |
| - | - | - | 8,358 |
| 25,784 | - | - | 25,784 |
| 10,178 | - | - | 10,178 |
| <u>\$ 419,456</u> | <u>\$ 56,400</u> | <u>\$ 111,177</u> | <u>\$ 2,291,739</u> |

| | | | |
|------|----------|-----------|-----------|
| \$ - | \$ 1,368 | \$ 13,165 | \$ 73,382 |
| - | - | - | 1,157 |
| - | - | - | 25,392 |
| - | - | 43,566 | 43,566 |
| - | 1,368 | 56,731 | 143,497 |

| | | | |
|---|---|---|---------|
| - | - | - | 12,616 |
| - | - | - | 145,211 |
| - | - | - | 157,827 |

| | | | |
|----------------|---------------|---------------|------------------|
| 25,784 | - | - | 25,784 |
| - | - | - | 24,802 |
| - | - | - | 15,000 |
| - | - | - | 8,358 |
| 53,744 | - | - | 53,744 |
| - | - | 45,559 | 45,559 |
| - | - | - | 67,303 |
| - | - | - | 107,753 |
| - | - | - | 78,985 |
| - | - | - | 72,491 |
| 339,928 | - | - | 339,928 |
| - | - | 63,945 | 63,945 |
| - | 55,032 | - | 55,032 |
| - | - | (55,058) | 1,031,731 |
| <u>419,456</u> | <u>55,032</u> | <u>54,446</u> | <u>1,990,415</u> |

| | | | |
|-------------------|------------------|-------------------|---------------------|
| <u>\$ 419,456</u> | <u>\$ 56,400</u> | <u>\$ 111,177</u> | <u>\$ 2,291,739</u> |
|-------------------|------------------|-------------------|---------------------|

This Page Has Been Intentionally Left Blank.

**CITY OF PEQUOT LAKES, MINNESOTA
RECONCILIATION OF THE GOVERNMENTAL FUNDS BALANCE SHEET TO THE
GOVERNMENT-WIDE STATEMENT OF NET POSITION
GOVERNMENTAL ACTIVITIES
DECEMBER 31, 2016**

| | | |
|---|------------------|----------------------------|
| FUND BALANCES - TOTAL GOVERNMENTAL FUNDS | | \$ 1,990,415 |
| Amounts reported for governmental activities in the statement of net position are different because: | | |
| Capital assets, net of accumulated depreciation, used in governmental activities are not financial resources and, therefore, are not reported in the governmental funds. | | 7,301,195 |
| Other long-term assets are not available to pay for current-period expenditures and, therefore, are deferred inflow of resources in the governmental funds. | | 157,827 |
| The City's Net Pension Asset, Net Pension Liability, and related deferred inflows and outflows of resources are recorded only on the statement of net position. Balances at year-end are: | | |
| Net Pension Asset | \$ 336,750 | |
| Net Pension Liability | (1,742,072) | |
| Deferred Inflows of Resources - Pension Related | (227,798) | |
| Deferred Outflows of Resources - Pension Related | <u>1,157,415</u> | (475,705) |
| Long-term liabilities, including bonds payable, are not due and payable in the current period and, therefore, are not reported in the governmental funds. | | |
| Equipment Certificates | (118,000) | |
| Loans Payable | (313,083) | |
| Capital Leases | (217,889) | |
| Compensated Absences | (46,533) | |
| Other Postemployment Benefits | (165,891) | |
| Accrued Interest Payable | <u>(10,151)</u> | <u>(871,547)</u> |
| NET POSITION OF GOVERNMENTAL ACTIVITIES | | \$ <u>8,102,185</u> |

See accompanying Notes to Financial Statements.

CITY OF PEQUOT LAKES, MINNESOTA
STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES
GOVERNMENTAL FUNDS
YEAR ENDED DECEMBER 31, 2016

| | Major Funds | |
|--|-----------------|--------------------|
| | General Fund | Fire Department |
| REVENUES | | |
| Taxes | \$ 1,563,406 | \$ - |
| Special Assessments | 580 | - |
| Licenses and Permits | 15,445 | - |
| Intergovernmental | 101,347 | 79,577 |
| Charges for Services | 128,463 | 193,560 |
| Fines and Forfeits | 16,546 | - |
| Gifts and Contributions | 65,482 | 3,706 |
| Investment Earnings | 11,263 | - |
| Miscellaneous | 69,146 | 37,460 |
| Total Revenues | 1,971,678 | 314,303 |
| EXPENDITURES | | |
| CURRENT | | |
| General Government | 467,626 | - |
| Public Safety | 702,433 | 182,965 |
| Highways and Streets | 345,353 | - |
| Sanitation | 9,468 | - |
| Culture and Recreation | 50,081 | - |
| Economic Development | 48,490 | - |
| CAPITAL OUTLAY | | |
| General Government | 12,289 | - |
| Public Safety | 76,575 | 80,836 |
| Highways and Streets | 185,874 | - |
| Culture and Recreation | 51,456 | - |
| DEBT SERVICE | | |
| Principal | 23,065 | 18,776 |
| Interest | 8,945 | 11,615 |
| Total Expenditures | 1,981,655 | 294,192 |
| EXCESS (DEFICIENCY) OF REVENUES OVER (UNDER) EXPENDITURES | (9,977) | 20,111 |
| OTHER FINANCING SOURCES (USES) | | |
| Proceeds from Sale of Assets | 16,844 | - |
| NET CHANGE IN FUND BALANCES | 6,867 | 20,111 |
| Fund Balance - Beginning of Year | 1,361,765 | 72,738 |
| FUND BALANCE - END OF YEAR | \$ 1,368,632 | \$ 92,849 |

See accompanying Notes to Financial Statements.

| Business Park | Highway 371 Project | Other Governmental Funds | Total Governmental Funds |
|---------------|---------------------|--------------------------|--------------------------|
| \$ - | \$ 21,000 | \$ 73,893 | \$ 1,658,299 |
| - | - | - | 580 |
| - | - | - | 15,445 |
| - | - | - | 180,924 |
| - | - | 2,800 | 324,823 |
| - | - | - | 16,546 |
| - | - | - | 69,188 |
| 1,999 | 1,900 | 335 | 15,497 |
| - | 7,641 | 17 | 114,264 |
| 1,999 | 30,541 | 77,045 | 2,395,566 |
| - | - | 225 | 467,851 |
| - | - | 10 | 885,408 |
| - | 42,039 | - | 387,392 |
| - | - | - | 9,468 |
| - | - | - | 50,081 |
| 947 | - | 30,254 | 79,691 |
| - | - | - | 12,289 |
| - | - | 1,397 | 158,808 |
| - | 100,414 | - | 286,288 |
| - | - | - | 51,456 |
| - | - | 38,000 | 79,841 |
| - | - | 3,627 | 24,187 |
| 947 | 142,453 | 73,513 | 2,492,760 |
| 1,052 | (111,912) | 3,532 | (97,194) |
| 355 | - | - | 17,199 |
| 1,407 | (111,912) | 3,532 | (79,995) |
| 418,049 | 166,944 | 50,914 | 2,070,410 |
| \$ 419,456 | \$ 55,032 | \$ 54,446 | \$ 1,990,415 |

This Page Has Been Intentionally Left Blank.

**CITY OF PEQUOT LAKES, MINNESOTA
RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES,
AND CHANGES IN FUND BALANCES OF GOVERNMENTAL FUNDS TO
THE GOVERNMENT-WIDE STATEMENT OF ACTIVITIES
GOVERNMENTAL ACTIVITIES
YEAR ENDED DECEMBER 31, 2016**

NET CHANGE IN FUND BALANCES - TOTAL GOVERNMENTAL FUNDS \$ (79,995)

Amounts reported for governmental activities in the statement of activities are different because:

Governmental funds report capital outlay as expenditures. However, in the statement of activities, the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense.

| | | |
|---|------------------|---------|
| Expenditures for General Capital Assets, Infrastructure, and Other Related Capital Assets Adjustments | \$ 525,330 | |
| Current Year Depreciation | <u>(399,769)</u> | 125,561 |

| | | |
|--|--|-------|
| In the statement of activities, only the gain or loss on the disposal of capital assets are reported whereas in the governmental funds, the proceeds from the disposal increase financial resources. Therefore, the change in net assets differs from the change in fund balance by the net cost of the disposed capital assets. | | 2,346 |
|--|--|-------|

| | | |
|---|--|----------|
| Revenues in the statement of activities that do not provide current financial resources are not reported as revenues in the governmental funds. | | (13,599) |
|---|--|----------|

| | | |
|---|--|-----------|
| Pension expenditures on the governmental funds are measured by current employee contributions. Pension expenses on the statement of activities is measured by the change in Net Pension Liability and the related deferred inflows and outflows of resources. | | (242,660) |
|---|--|-----------|

Repayment of debt principal is an expenditure in the governmental funds, but the repayment reduces long-term liabilities in the statement of net position.

| | | |
|------------------------|---------------|--------|
| Principal Repayments | | |
| Equipment Certificates | 38,000 | |
| Loans Payable | 18,776 | |
| Capital Leases | <u>25,930</u> | 82,706 |

Some expenses reported in the statement of activities do not require the use of current financial resources and, therefore, are not reported as expenditures in governmental funds.

| | | |
|---|-----------------|-----------------|
| Change in Accrued Interest Payable | 966 | |
| Change in Compensated Absences | (7,005) | |
| Change in Other Postemployment Benefits | <u>(15,891)</u> | <u>(21,930)</u> |

CHANGE IN NET POSITION OF GOVERNMENTAL ACTIVITIES \$ (147,571)

See accompanying Notes to Financial Statements.

**CITY OF PEQUOT LAKES, MINNESOTA
STATEMENT OF NET POSITION
PROPRIETARY FUNDS
DECEMBER 31, 2016**

| | Water Fund | Sewer Fund | Total |
|--|---------------|---------------|--------------|
| ASSETS | | | |
| CURRENT ASSETS | | | |
| Cash and Investments | \$ 704,428 | \$ 696,359 | \$ 1,400,787 |
| Special Assessments | | | |
| Noncurrent | 1,885 | 1,814 | 3,699 |
| Accounts Receivable (Net) | 50,125 | 86,988 | 137,113 |
| Total Current Assets | 756,438 | 785,161 | 1,541,599 |
| NONCURRENT ASSETS | | | |
| Capital Assets | | | |
| Land | 21,198 | 156,969 | 178,167 |
| Buildings (Net) | 16,127 | 44,632 | 60,759 |
| Machinery, Vehicles, Furniture, and Equipment (Net) | 1,144,075 | 172,749 | 1,316,824 |
| Infrastructure (Net) | 81,962 | 1,272,208 | 1,354,170 |
| Total Noncurrent Assets | 1,263,362 | 1,646,558 | 2,909,920 |
| Total Assets | 2,019,800 | 2,431,719 | 4,451,519 |
| DEFERRED OUTFLOWS OF RESOURCES | | | |
| Pension Related | 5,169 | 5,169 | 10,338 |
| LIABILITIES | | | |
| CURRENT LIABILITIES | | | |
| Accounts Payable | 40,695 | 68,687 | 109,382 |
| Salaries Payable | 637 | 637 | 1,274 |
| Due to Other Governments | 49 | 49 | 98 |
| Accrued Interest Payable | 10,104 | - | 10,104 |
| Compensated Absences Payable | 394 | 394 | 788 |
| General Obligation Bonds Payable - Due Within One Year | 60,000 | - | 60,000 |
| Capital Notes Payable - Due Within One Year | 262 | 262 | 524 |
| Total Current Liabilities | 112,141 | 70,029 | 182,170 |
| NONCURRENT LIABILITIES | | | |
| General Obligation Bonds Payable - Due in More than One Year | 971,862 | - | 971,862 |
| Capital Leases Payable - Due in More than One Year | 960 | 960 | 1,920 |
| Compensated Absences Payable - Due in More than One Year | 942 | 942 | 1,884 |
| Net Pension Liability - Due in More than One Year | 14,424 | 14,424 | 28,848 |
| Other Postemployment Benefits Payable - Due in More than One Year | 9,003 | 9,002 | 18,005 |
| Total Noncurrent Liabilities | 997,191 | 25,328 | 1,022,519 |
| Total Liabilities | 1,109,332 | 95,357 | 1,204,689 |
| DEFERRED INFLOWS OF RESOURCES | | | |
| Pension Related | 2,245 | 2,245 | 4,490 |
| NET POSITION | | | |
| Net Investment in Capital Assets | 230,278 | 1,645,336 | 1,875,614 |
| Unrestricted | 683,114 | 693,950 | 1,377,064 |
| Total Net Position | \$ 913,392 | 2,339,286 | \$ 3,252,678 |

See accompanying Notes to Financial Statements.

CITY OF PEQUOT LAKES, MINNESOTA
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION
PROPRIETARY FUNDS
YEAR ENDED DECEMBER 31, 2016

| | Water Fund | Sewer Fund | Total |
|---|-------------------|---------------------|---------------------|
| OPERATING REVENUES | | | |
| Charges for Services | \$ 268,364 | \$ 281,304 | \$ 549,668 |
| Miscellaneous Operating | 9,886 | 2,036 | 11,922 |
| Total Operating Revenues | 278,250 | 283,340 | 561,590 |
| OPERATING EXPENSES | | | |
| CURRENT | | | |
| Personal Services | 11,927 | 11,926 | 23,853 |
| Professional Services | 29,456 | 27,776 | 57,232 |
| Other Services and Charges | 7,681 | 2,069 | 9,750 |
| Supplies | 22,998 | 4,914 | 27,912 |
| Repairs and Maintenance | 12,222 | 27,702 | 39,924 |
| Utilities | 15,754 | 17,355 | 33,109 |
| Insurance | 2,241 | 5,033 | 7,274 |
| Dues and Subscriptions | 5,458 | 1,789 | 7,247 |
| Depreciation | 63,765 | 26,616 | 90,381 |
| Total Operating Expenses | 171,502 | 125,180 | 296,682 |
| OPERATING INCOME (LOSS) | 106,748 | 158,160 | 264,908 |
| NONOPERATING REVENUES (EXPENSES) | | | |
| Intergovernmental | 73 | 506,073 | 506,146 |
| Special Assessment Charges | 950 | 912 | 1,862 |
| Interest Income | 2,121 | 8,892 | 11,013 |
| Interest Expense | (24,621) | - | (24,621) |
| Total Nonoperating Revenues (Expenses) | (21,477) | 515,877 | 494,400 |
| CHANGE IN NET POSITION | 85,271 | 674,037 | 759,308 |
| Net Position - Beginning of Year | 828,121 | 1,665,249 | 2,493,370 |
| NET POSITION - END OF YEAR | <u>\$ 913,392</u> | <u>\$ 2,339,286</u> | <u>\$ 3,252,678</u> |

See accompanying Notes to Financial Statements.

**CITY OF PEQUOT LAKES, MINNESOTA
STATEMENT OF CASH FLOWS
PROPRIETARY FUNDS
YEAR ENDED DECEMBER 31, 2016**

| | Water Fund | Sewer Fund | Total |
|--|-------------------|-------------------|---------------------|
| CASH FLOWS FROM OPERATING ACTIVITIES | | | |
| Receipts from Customers and Users | \$ 276,756 | \$ 279,571 | \$ 556,327 |
| Payments to Suppliers | (91,883) | (87,000) | (178,883) |
| Payments to Employees | (15,299) | (15,298) | (30,597) |
| Net Cash Provided (Used) by Operating Activities | <u>169,574</u> | <u>177,273</u> | <u>346,847</u> |
| CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES | | | |
| Intergovernmental | 73 | 506,073 | 506,146 |
| CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES | | | |
| Principal Paid on Long-Term Debt | (60,124) | - | (60,124) |
| Interest Paid on Long-Term Debt | (24,846) | - | (24,846) |
| Special Assessments | (9) | (15) | (24) |
| Purchases of Capital Assets | (8,199) | (985,121) | (993,320) |
| Net Cash Provided (Used) by Capital and Related Financing Activities | <u>(93,178)</u> | <u>(985,136)</u> | <u>(1,078,314)</u> |
| CASH FLOWS FROM INVESTING ACTIVITIES | | | |
| Investment Earnings Received | <u>2,121</u> | <u>8,892</u> | <u>11,013</u> |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | | | |
| | 78,590 | (292,898) | (214,308) |
| Cash and Cash Equivalents - Beginning of Year | <u>625,838</u> | <u>989,257</u> | <u>1,615,095</u> |
| CASH AND CASH EQUIVALENTS - END OF YEAR | | | |
| | <u>\$ 704,428</u> | <u>\$ 696,359</u> | <u>\$ 1,400,787</u> |
| Reconciliation of Operating Income (Loss) to Net Cash Provided (Used) by Operating Activities | | | |
| Operating Income (Loss) | \$ 106,748 | \$ 158,160 | \$ 264,908 |
| Adjustments to Reconcile Operating Income (Loss) to Net Cash Provided (Used) by Operating Activities | | | |
| Net Cash Provided (Used) by Operating Activities | | | |
| Depreciation Expense | 63,765 | 26,616 | 90,381 |
| (Increase) Decrease in Accounts Receivable | (1,494) | (3,769) | (5,263) |
| (Increase) Decrease in Deferred Outflow of Resources | (3,436) | (3,436) | (6,872) |
| Increase (Decrease) in Accounts Payable | 3,954 | (335) | 3,619 |
| Increase (Decrease) in Salaries Payable | 135 | 135 | 270 |
| Increase (Decrease) in Due to Other Governments | (27) | (27) | (54) |
| Increase (Decrease) in Compensated Absences Payable | 91 | 91 | 182 |
| Increase (Decrease) in Other Postemployment Benefits Payable | 691 | 691 | 1,382 |
| Increase (Decrease) in Net Pension Liability | (954) | (954) | (1,908) |
| Increase (Decrease) in Deferred Inflows of Resources | 101 | 101 | 202 |
| Total Adjustments | <u>62,826</u> | <u>19,113</u> | <u>81,939</u> |
| Net Cash Provided (Used) by Operating Activities | <u>\$ 169,574</u> | <u>\$ 177,273</u> | <u>\$ 346,847</u> |
| NONCASH INVESTING, CAPITAL AND FINANCING ACTIVITIES | | | |
| Amortization of Current Year Bond Premium | \$ 124 | \$ - | \$ 124 |
| Purchase of Assets through Lease | 1,459 | 1,459 | 2,918 |
| Net Noncash Investing, Capital and Financing Activities | <u>\$ 1,583</u> | <u>\$ 1,459</u> | <u>\$ 3,042</u> |

See accompanying Notes to Financial Statements.

**CITY OF PEQUOT LAKES, MINNESOTA
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2016**

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial statements of the City of Pequot Lakes (the City) are prepared in accordance with generally accepted accounting principles (GAAP). The Governmental Accounting Standards Board (GASB) is responsible for establishing GAAP for state and local governments through its pronouncements (statements and interpretations). The more significant accounting policies established in GAAP and used by the City are discussed below:

A. Financial Reporting Entity

The City of Pequot Lakes was formed and operates pursuant to applicable Minnesota laws. The City operates under a Mayor-Council form of government with a full-time City Clerk-Treasurer and provides the following services: public safety (police and fire), public works, culture-recreation, public improvements, planning and zoning, and general administrative services. The City also operates public water and sewer utilities.

As required by generally accepted accounting principles, these financial statements present City of Pequot Lakes (primary government) and its component units for which the City is financially accountable. There is financial accountability if the Primary Government appoints a voting majority of an organization's governing body and has the ability to impose its will on that governing body; or there is the potential for the organization to provide specific financial benefits or to impose specific financial burden on the Primary Government. Based on the criteria for determining component units, the City is not required to include any component units.

B. Government-Wide and Fund Financial Statements

The government-wide financial statements (i.e., the statement of net position and the statement of activities) report information about the Primary Government. These statements include the financial activities of the overall City government. Eliminations have been made to minimize the double-counting of internal activities. Governmental activities, which normally are supported by taxes and intergovernmental revenues, are reported separately from business-type activities, which rely to a significant extent on fees and charges to external parties for support.

The statement of activities demonstrates the degree to which the direct expenses of each function of the City's governmental activities and different business-type activity are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function or activity. Program revenues include: (1) fees, fines, and charges paid by the recipients of goods, services, or privileges provided by a given function or activity; and (2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or activity. Revenues that are not classified as program revenues, including all taxes, are presented as general revenues.

**CITY OF PEQUOT LAKES, MINNESOTA
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2016**

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

B. Government-Wide and Fund Financial Statements (Continued)

Separate financial statements are provided for governmental funds and proprietary funds. Major individual governmental funds and major individual enterprise funds are reported as separate columns in the fund financial statements.

The City reports the following major governmental funds:

General Fund - The General Fund is the general operating fund of the City. It accounts for all the financial resources of the general government, except those required to be accounted for in another fund.

Fire Department Fund – The Fire Fund, a special revenue fund, is used to account for charges for services, grants, and contributions that are restricted and committed for the operation and maintenance of the fire service to the City and surrounding areas.

Business Park Fund – The Business Park Fund, a special revenue fund, is used to account for special assessments and other revenue committed to the fund.

Highway 371 Project – The Highway 371 Project Fund, a capital projects fund, is used to account for capital improvements on Highway 371 within the City.

The City reports the following major proprietary funds:

Water Fund – The Water Fund accounts for the activities of the City's water wells' operations.

Sewer Fund – The Sewer Fund accounts for the activities of the City's sewer system.

C. Measurement Focus and Basis of Accounting

The government-wide and proprietary fund financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned, and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Property taxes are recognized as revenues in the year for which they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. The City considers all revenues to be available if they are collected within 60 days after the end of the current period. Expenditures are recorded when the related fund liability is incurred, except for principal and interest on general long-term debt, and compensated absences, which are recognized as expenditures to the extent that they have matured. Proceeds of general long-term debt and acquisitions under capital leases are reported as other financing sources.

**CITY OF PEQUOT LAKES, MINNESOTA
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2016**

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

C. Measurement Focus and Basis of Accounting (Continued)

Property taxes, franchise taxes, licenses, and interest associated with the current fiscal period are all considered to be susceptible to accrual. Only the portion of special assessments receivable due within the current fiscal period is considered to be susceptible to accrual as revenue of the current period. All other revenue items are considered to be measurable and available only when cash is received by the government.

When both restricted and unrestricted resources are available for use, it is the City's policy to use restricted resources first, then unrestricted resources as they are needed.

Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenue of the City's enterprise funds are charges to customers for sales of goods and services. Operating expenses for enterprise funds include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

D. Assets, Liabilities, Deferred Inflows of Resources, and Net Position or Equity

1. Cash and Investments (Including Cash Equivalents)

Cash balances are invested to the extent available in various securities as authorized by Minnesota Statutes. Investment earnings are recorded in the individual fund carrying the investment. Investments are stated at fair value.

Cash equivalents are considered to be short-term, highly-liquid investments that are readily convertible to cash and have original maturities of three months or less.

For the purposes of the statement of cash flows of the proprietary fund types, the City considers all cash and investments under the classifications current assets to be cash and cash equivalents. Cash and cash equivalents consist of checking and savings certificate accounts, cash on hand, and money market savings accounts.

2. Short-Term Interfund Receivables/Payables

During the course of operations, numerous transactions occur between individual funds for goods provided or services rendered. These receivables and payables are classified as "due from other funds" or "due to other funds" on the fund financial statements. Any residual balances outstanding between the governmental activities and business-type activities are reported in the government-wide financial statements as internal balances.

**CITY OF PEQUOT LAKES, MINNESOTA
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2016**

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

D. Assets, Liabilities, Deferred Inflows of Resources, and Net Position or Equity
(Continued)

3. Accounts Receivable

The City has provided an allowance for uncollectible accounts receivable based on specific identification method. An allowance is estimated for these loans based on the historical experience of the City and knowledge of TIF District 1-13's operations. At December 31, 2016, the allowance for uncollectible accounts receivable in the TIF 1-13 fund is \$63,400.

4. Special Assessments

Special assessments are levied against the benefited properties for the assessable costs of improvement projects in accordance with Minnesota Statutes. Assessments are collectible over a term of years at an interest rate established by the City Council upon adoption of each assessment roll. Any annual installments remaining unpaid as of November 30th of each year are certified to the County for collection with property taxes during the following year.

Special assessments receivable represents the past six years of uncollected special assessments. Property owners are allowed to prepay future installments without interest or prepayment penalties.

In the governmental fund financial statements, special assessment levies are recorded as a receivable and as deferred revenue at the time of the levy. Deferred revenue is recognized as current revenue as the annual assessment installments become measurable and available. Interest on special assessments is also recognized when it becomes measurable and available.

5. Capital Assets

Capital assets, which include property, plant, equipment, and infrastructure assets (e.g., roads, bridges, sidewalks, and similar items) are reported in the applicable governmental or business-type activities columns in the government-wide financial statements. In the case of the initial capitalization of infrastructure, the City retroactively implemented the reporting of this item when GASB Statement No. 34 was implemented. Capital assets are defined by the government as assets with an initial, individual cost of more than \$2,500 and an estimated useful life in excess of one year. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair market value at the date of donation.

The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend assets' lives are not capitalized. Major outlays for capital assets and improvements are capitalized as projects are constructed. Interest incurred during the construction phase of capital assets of business-type activities, when applicable, is included as part of the capitalized value of the assets constructed.

**CITY OF PEQUOT LAKES, MINNESOTA
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2016**

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

D. Assets, Liabilities, Deferred Inflows of Resources, and Net Position or Equity (Continued)

5. Capital Assets (Continued)

Capital assets of the Primary Government are depreciated using the straight-line method over the following estimated useful lives:

| Assets | Years |
|-------------------------------------|-------|
| Buildings | 25-75 |
| Infrastructure | 15-75 |
| Machinery, Furniture, and Equipment | 3-15 |

6. Deferred Outflows of Resources

The City reports decreases in net position that relate to future periods as deferred outflows of resources in a separate section of its statements of net position. The deferred outflows of resources reported in the financial statements consist of unrecognized items not yet charged to pension expense and contributions from the employer after the measurement date but before the end of the employer's reporting period.

7. Compensated Absences

Compensated absences include accumulated vacation, compensatory time, and sick leave. All full-time employees of the City are entitled to annual vacation and sick leave with pay. Employees are allowed to accumulate 120 hours of vacation time to carry over to the following year. Employees earn vacation from 40 to 160 hours per year, depending on length of service. Sick leave of one day per month is earned with a 960 hour maximum. Upon retirement, the employee is paid for all accumulated, unused vacation and a portion of the unused sick leave. Unused sick leave is paid out at termination for full-time employees as follows: 10 percent of total unused sick leave if five to nine years of service, and 25 percent of unused sick leave if more than ten years of service with the City.

Compensated absences (including sick leave payments) are accrued when incurred in the government-wide financial statements. A liability and related expenditure for these amounts is reported in the governmental funds only if they have matured, for example, as a result of known employee resignations and retirements.

In the City's proprietary funds, amounts earned but unused for vacation leave and that portion of earned but unused sick leave estimated to be payable upon retirement are reflected under the accrual basis of accounting.

8. Other Postemployment Benefits

In the government-wide financial statements, and proprietary fund types in the fund financial statements, other postemployment benefit obligations are reported as liabilities in the applicable governmental activities, business-type activities, or proprietary fund type statement of net position. These other postemployment benefit liabilities are an estimate based on an actuarial valuation.

**CITY OF PEQUOT LAKES, MINNESOTA
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2016**

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

D. Assets, Liabilities, Deferred Inflows of Resources, and Net Position or Equity
(Continued)

9. Long-Term Obligations

In the government-wide financial statements, and proprietary fund types in the fund financial statements, long-term debt and other long-term obligations are reported as liabilities in the applicable governmental activities, business-type activities, or proprietary fund type statement of net position. Bond premiums and discounts are amortized over the life of the bonds or loans payable using the straight-line method. Bonds payable are reported net of the applicable bond premium or discount. Bond issuance costs are expensed when incurred.

In the fund financial statements, governmental fund types recognize bond premiums and discounts, as well as bond issuance costs, during the current period. The face amount of debt issued is reported as other financing sources. Premiums received on debt issuances are reported as other financing sources while discounts on debt issuances are reported as other financing uses. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as debt service expenditures.

10. Pensions

For purposes of measuring the net pension liability, deferred outflows/inflows of resources, and pension expense, information about the fiduciary net position of the Public Employees Retirement Association (PERA) and additions to/deductions from PERA's fiduciary net position have been determined on the same basis as they are reported by PERA except that PERA's fiscal year end is June 30. For this purpose, plan contributions are recognized as of employer payroll paid dates and benefit payments and refunds are recognized when due and payable in accordance with the benefit terms. Investments are reported at fair value.

For purposes of measuring the liability, deferred outflows of resources and deferred inflows of resources, and expense associated with the City's requirement to contribute to the Pequot Lakes Firefighters Relief Association Plan, information about the Plan's fiduciary net position and additions to/deductions from the Pequot Lakes Firefighters Relief Association Plan's fiduciary net position have been determined on the same basis as they are reported by the Plan. For this purpose, benefit payments (including refunds of contributions) are recognized when due and payable in accordance with the benefit terms. Investments are reported at fair value.

11. Deferred Inflows of Resources

The City's governmental fund financial statements report a separate section for deferred inflows of resources. This separate financial statement element reflects an increase in fund balance that applies to a future period. The City will not recognize the related revenue until a future event occurs. The deferred inflow of resources occurs because governmental fund revenues are not recognized until available (collected not later than 60 days after the end of the City's year) under the modified accrual basis of accounting.

**CITY OF PEQUOT LAKES, MINNESOTA
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2016**

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

D. Assets, Liabilities, Deferred Inflows of Resources, and Net Position or Equity
(Continued)

12. Fund Balance/Net Position

In the fund financial statements, governmental funds report components of fund balance to provide information about fund balance availability for appropriation. Nonspendable fund balance represents amounts that are inherently nonspendable or assets that will never be converted to cash or will be converted to cash soon enough to affect the current period. Restricted fund balance represents amounts available for appropriation but intended for a specific use and is legally restricted by outside parties. Committed fund balance represents constraints on spending that the government imposes upon itself by high-level formal action prior to the close of the fiscal period. Assigned fund balance represents resources intended for spending for a purpose set by the government body itself or by some person or body delegated to exercise such authority in accordance with policy established by the board. Unassigned fund balance is the residual classification for the City's general fund and includes all spendable amounts not contained in the other classifications. It is the City's policy that at the end of each fiscal, the City will set aside fund balance in the general fund up to 50 percent of the following year's general fund budgeted expenditures for cash flow purposes.

When an expenditure is incurred for purposes for which both restricted and unrestricted fund balance is available, it is the City's policy to use restricted first, then unrestricted fund balance. When an expenditure is incurred for purposes for which committed, assigned, and unassigned amounts are available, it is the City's policy to use committed first, then assigned, and finally unassigned amounts.

Net position represents the difference between assets, deferred inflows, deferred outflows, and liabilities in the government-wide financial statements. Net investment in capital assets consists of capital assets, net of accumulated depreciation, reduced by the outstanding balance of any long-term debt used to build or acquire capital assets. Net position is reported as restricted in government-wide financial statements when there are limitations on its use through external restrictions imposed by creditors, grantors, or laws or regulations of other governments.

**CITY OF PEQUOT LAKES, MINNESOTA
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2016**

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

E. Revenues, Expenditures, and Expenses

1. Revenues

In the fund financial statements, property taxes are recognized to the extent they are collected and received in the current period or within 60 days after year-end. Portions paid by the State in the form of market value credit aid, and other state tax credits are included in intergovernmental revenues. Delinquent property taxes receivable which have not been recognized as revenue are equally offset in the financial statements by deferred revenues.

Licenses and permits, charges for services, fines, forfeits, and miscellaneous revenues are recorded as revenues when measurable and available.

Special assessments principal and interest earnings are recorded as revenues in the same manner as property taxes.

Property Tax Collection Calendar

The City levies its property taxes for the subsequent year during the month of December. In Minnesota, the lien date and assessment date is January 2. The property tax is recorded as revenue when it becomes available. Crow Wing County is the collecting agency for the levy and then remits the collection to the City. All taxes not collected as of December 31 are shown as delinquent taxes receivable.

The County Auditor prepares the tax list for all taxable property in the City, applying the applicable tax capacity rate to the tax capacity value of individual properties, to arrive at the actual tax for each property. The County Auditor also collects all special assessments, except for certain payments paid directly to the City.

The County Auditor provides a list of taxes and special assessments to be collected on each parcel of property to the County Treasurer in January of each year.

Property owners are required to pay one-half of their real estate taxes by May 15 and the balances by October 15.

Within 30 days after the May settlement, the County Treasurer is required to pay 70 percent of the estimated collections of taxes and special assessments to the City Treasurer. The County Treasurer must pay the balance to the City Treasurer within 60 days after the settlement, provided that after 45 days interest begins to accrue.

**CITY OF PEQUOT LAKES, MINNESOTA
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2016**

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

E. Revenues, Expenditures, and Expenses (Continued)

1. Revenues (Continued)

Property Tax Collection Calendar (Continued)

Current year property tax revenues represent the tax levy certified to the County Auditor in December 2015, which was collected during the year ended December 31, 2016. Any adjustments or abatements to either the current, or any prior year, levy are adjusted through the current year general property tax revenues. Property taxes not collected by the County and remitted to the City within 60 days of year end are classified as delinquent and not considered measurable and available and are fully offset by deferred revenue in the governmental fund financial statements. Delinquent taxes receivable represent the past six years of uncollected tax years. No allowance for uncollectible taxes has been provided because such amounts are not expected to be material.

Within ten business days after November 15, the County Treasurer shall pay to each taxing district, except any school district, 100 percent of the estimated collections arising from taxes levied by and belonging to each taxing district from May 20 to November 20.

2. Expenditures

Expenditure recognition for governmental fund types includes only amounts represented by current liabilities. Since noncurrent liabilities do not affect net current assets, they are not recognized as governmental fund expenditures or liabilities. They are reported as liabilities on the statement of net position.

3. Expenses

Proprietary funds recognize expenses, including compensated absences, when they are incurred.

F. Prior Period Comparative Financial Information/Reclassification

Certain amounts presented in the prior year data have been reclassified in order to be consistent with the current year's presentation.

NOTE 2 STEWARDSHIP, COMPLIANCE, AND ACCOUNTABILITY

A. Expenditures in Excess of Appropriations

In the following funds, expenditures exceeded the appropriations during the year ended December 31, 2016:

| | <u>Expenditures</u> | <u>Budget</u> | <u>Excess</u> |
|------------------------|---------------------|---------------|---------------|
| General Fund | \$ 1,981,655 | \$ 1,862,587 | \$ 119,068 |
| Special Revenue Funds: | | | |
| Fire Fund | 294,192 | 211,240 | 82,952 |

The above overages were considered by the City's management to be the result of necessary expenditures critical to operations and were approved by the Council. They were funded by an increase in revenues.

**CITY OF PEQUOT LAKES, MINNESOTA
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2016**

NOTE 2 STEWARDSHIP, COMPLIANCE, AND ACCOUNTABILITY (CONTINUED)

B. Deficit Fund Balance

The TIF 1-13 Lonesome Cottage Special Revenue Fund had a deficit fund balance as of December 31, 2016. The amount of the deficit is \$55,058, and is due to timing of when the expenditures occurred in the funds and when the revenues will be received in the future. The deficit will be corrected through normal government operations as taxes are collected in the future and transfers, as needed.

NOTE 3 DETAILED NOTES ON ALL FUNDS

A. Assets

1. Deposits and Investments

The cash balances of substantially all funds are pooled by the City Administrator/Clerk for the purpose of increasing earning through investment activities. Pooled and fund investments are reported at their fair value at December 31, 2016, based on market prices. Investment earnings on cash and pooled investments are credited to the general fund. In addition other funds received investment earnings based on other state statutes, grant agreements, contracts, and bond covenants.

In accordance with applicable Minnesota State Statutes, the City maintains deposits at financial institutions authorized by the City Council. All such deposits are members of the Federal Reserve System. Minnesota Statutes require that all deposits be protected by insurance, surety bond, or collateral. The market value of collateral pledged must equal 110 percent of the deposits not covered by insurance or corporate surety bonds.

Custodial Credit Risk – Deposits – In the case of deposits, custodial credit risk is the risk that in the event of bank failure, the City’s deposits may not be returned to it. The City’s deposit policy does not provide additional restrictions beyond Minnesota State Statutes to the type of risk.

Authorized collateral includes: U.S. government treasury bills, notes, and or bonds; issued of the U.S. government agency; general obligation of local government related “A” or better; revenue obligations of a state or local government rated “AA” or better; irrevocable standby letters of credit issued by a Federal Home Loan Bank; and time deposits insured by a federal agency. Minnesota Statutes require securities pledged as collateral be held in safekeeping in a restricted account at the Federal Reserve Bank or at an account at a trust department of a commercial bank or other financial institution not owned or controlled by the depository. As of December 31, 2016, no City deposits were subject to custodial credit risk.

**CITY OF PEQUOT LAKES, MINNESOTA
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2016**

NOTE 3 DETAILED NOTES ON ALL FUNDS (CONTINUED)

A. Assets (Continued)

1. Deposits and Investments (Continued)

Minnesota Statutes §§ 118A.04 and 118A.05 generally authorize the following types of investments as available to the City:

- a) securities which are direct obligations or are guaranteed or insured issues of the United States, its agencies, its instrumentalities, or organizations created by an act of Congress, except mortgage-backed securities defined as “high risk” by Minnesota Statutes §118A.04, subd. 6;
- b) mutual funds through shares of registered investment companies provided the mutual fund receives certain ratings depending on its investments;
- c) general obligations of the state of Minnesota and its municipalities, and in certain state agency and local obligations of Minnesota and other states provided such obligations have certain specified bond ratings by a national bond rating service;
- d) bankers’ acceptances of United States banks;
- e) commercial paper issued by United States corporations or their Canadian subsidiaries that is rated in the highest quality category by two nationally recognized rating agencies and matures in 270 days or less; and
- f) with certain restrictions, in repurchase agreements, securities lending agreements, joint powers investment trusts, and guaranteed investment contracts.

Interest Rate Risk – Interest rate risk is defined as the risk that changes in interest rates will adversely affect the fair value of an investment. The City’s investment policy requires the City to diversify its investment portfolio to eliminate the risk of loss resulting from over concentration of assets in a specific maturity. The policy also states the City’s investment portfolio will remain sufficiently liquid to enable the City to meet all operating requirements which might be reasonably anticipated. Investments are categorized to give an indication of the level of interest rate risk assumed at year-end. Fair market values and maturities as of December 31, 2016 are as follows:

| Type | Total Fair Value | Less Than 1 Year | 1 to 2 Years | 3 to 5 Years | More than 5 Years |
|---|---------------------|---------------------|-------------------|-------------------|----------------------|
| Money Market Funds | \$ 62,088 | \$ 62,088 | \$ - | \$ - | \$ - |
| U.S. Treasury Notes | 363,155 | - | 41,908 | 168,796 | 152,451 |
| Federal Home Loan Mortgage Corporation Notes | 76,231 | - | - | - | 76,231 |
| Federal Home Loan Mortgage Corporation Med Term Notes | 72,010 | - | - | 72,010 | - |
| Municipal Bonds | 977,010 | 100,465 | 201,626 | 305,195 | 369,724 |
| Total | <u>\$ 1,550,494</u> | <u>\$ 162,553</u> | <u>\$ 243,534</u> | <u>\$ 546,001</u> | <u>\$ 598,406</u> |

**CITY OF PEQUOT LAKES, MINNESOTA
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2016**

NOTE 3 DETAILED NOTES ON ALL FUNDS (CONTINUED)

A. Assets (Continued)

1. Deposits and Investments (Continued)

Concentration of Credit Risk – The risk of loss attributed to the magnitude of the City’s investments in a single issuer. The City places no limit on the amount that may be invested in any one issuer.

| <u>Type</u> | <u>Amount</u> | <u>Percentage</u> |
|--------------------|---------------|-------------------|
| U.S. Treasury Note | \$ 101,754 | 6.56 % |
| Wyoming SNTY PA | 77,576 | 5.00 |

Credit Risk – Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. State law limits investments in commercial paper and corporate bonds to the top two rating issued by nationally recognized statistical rating organizations. The City’s policy states the City Administrator/Clerk is expected to display prudence in the selection of securities as a way to minimize default risk. No individual investment transaction shall be undertaken which jeopardizes the total capital position of the overall portfolio. To control market price risk, volatile investment instruments shall be avoided.

| <u>Type</u> | <u>Quality Rating</u> | <u>Amount</u> |
|---|-----------------------|---------------------|
| Money Market Funds | N/A | \$ 62,088 |
| Municipal Bonds | AA1-AA3 | 977,010 |
| Federal Home Loan Mortgage Corporation Notes | AAA | 76,231 |
| Federal Home Loan Mortgage Corporation Med Term Notes | AAA | 72,010 |
| U.S. Treasury Note | AAA | 363,155 |
| Total | | <u>\$ 1,550,494</u> |

At December 31, 2016, the City’s deposit and investment balances were as follows:

| | |
|--|---------------------|
| Cash and Investments - Governmental Funds | \$ 1,981,729 |
| Petty Cash and Change Funds - Governmental Funds | 942 |
| Cash and Investments - Proprietary Funds | 1,400,787 |
| Total Cash & Cash Equivalents | <u>\$ 3,383,458</u> |

**CITY OF PEQUOT LAKES, MINNESOTA
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2016**

NOTE 3 DETAILED NOTES ON ALL FUNDS (CONTINUED)

A. Assets (Continued)

2. Fair Value Measurements

The District uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures.

The District follows an accounting standard that defines fair value, establishes a framework for measuring fair value, establishes a fair value hierarchy based on the quality of inputs used to measure fair value, and requires expanded disclosures about fair value measurements. In accordance with this standard, the District has categorized its investments, based on the priority of the inputs to the valuation technique, into a three-level fair value hierarchy. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). If the inputs used to measure the financial instruments fall within different levels of the hierarchy, the categorization is based on the lowest level input that is significant to the fair value measurement of the instrument.

Financial assets and liabilities recorded on the combined statements of financial position are categorized based on the inputs to the valuation techniques as follows:

Level 1 – Financial assets and liabilities are valued using inputs that are unadjusted quoted prices in active markets accessible at the measurement date of identical financial assets and liabilities. The inputs include those traded on an active exchange, such as the New York Stock Exchange, as well as U.S. Treasury and other U.S. government and agency mortgage-backed securities that are traded by dealers or brokers in active over-the-counter markets.

Level 2 – Financial assets and liabilities are valued based on quoted prices for similar assets, or inputs that are observable, either directly or indirectly for substantially the full term through corroboration with observable market data.

Level 3 – Financial assets and liabilities are valued using pricing inputs which are unobservable for the asset, inputs that reflect the reporting entity’s own assumptions about the assumptions market participants and would use in pricing the asset.

Assets measured at fair value on a recurring basis:

| Type | Level 1 | Level 2 | Level 3 | Total |
|-------------------------------|-------------------|---------------------|-------------|---------------------|
| Government Obligations | \$ 363,155 | \$ 148,241 | \$ - | \$ 511,396 |
| Municipal Bonds | - | 977,010 | - | 977,010 |
| Total | <u>\$ 363,155</u> | <u>\$ 1,125,251</u> | <u>\$ -</u> | 1,488,406 |
| Investments at Amortized Cost | | | | |
| Money Market | | | | 62,088 |
| Total Investments | | | | <u>\$ 1,550,494</u> |

**CITY OF PEQUOT LAKES, MINNESOTA
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2016**

NOTE 3 DETAILED NOTES ON ALL FUNDS (CONTINUED)

A. Assets (Continued)

3. Capital Assets

Capital asset activity for the governmental activities of the City for the year ended December 31, 2016, is as follows:

| | Beginning Balance | Additions | Deletions | Ending Balance |
|---|----------------------|------------|------------|-------------------|
| Capital Assets, not Being Depreciated | | | | |
| Land and Right of Way | \$ 1,504,339 | \$ - | \$ - | \$ 1,504,339 |
| Construction in Progress | 86,051 | 178,122 | 182,580 | 81,593 |
| Total Capital Assets not Being Depreciated | 1,590,390 | 178,122 | 182,580 | 1,585,932 |
| Capital Assets Being Depreciated | | | | |
| Buildings | 1,536,861 | 12,289 | - | 1,549,150 |
| Machinery, Vehicles, Furniture, and Equipment | 2,694,578 | 307,919 | 64,200 | 2,938,297 |
| Infrastructure | 5,778,773 | 209,580 | - | 5,988,353 |
| Total Capital Assets Being Depreciated | 10,010,212 | 529,788 | 64,200 | 10,475,800 |
| Less: Accumulated Depreciation for | | | | |
| Buildings | 590,654 | 54,901 | - | 645,555 |
| Machinery, Vehicles, Furniture, and Equipment | 1,442,622 | 148,843 | 66,546 | 1,524,919 |
| Infrastructure | 2,394,038 | 196,025 | - | 2,590,063 |
| Total Accumulated Depreciation | 4,427,314 | 399,769 | 66,546 | 4,760,537 |
| Total Capital Assets, Depreciated, Net | 5,582,898 | 130,019 | (2,346) | 5,715,263 |
| Governmental Activities Capital Assets, Net | \$ 7,173,288 | \$ 308,141 | \$ 180,234 | \$ 7,301,195 |

CITY OF PEQUOT LAKES, MINNESOTA
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2016

NOTE 3 DETAILED NOTES ON ALL FUNDS (CONTINUED)

A. Assets (Continued)

3. Capital Assets (Continued)

The following is a summary of the proprietary fund capital assets for the year ended December 31, 2016:

| | Beginning Balance | Additions | Deletions | Ending Balance |
|--|----------------------|--------------|--------------|----------------|
| Capital Assets, not Being Depreciated | | | | |
| Land | \$ 178,167 | \$ - | \$ - | \$ 178,167 |
| Construction-in-Progress | 96,047 | 960,276 | 1,056,323 | - |
| Total Capital Assets not Being Depreciated | 274,214 | 960,276 | 1,056,323 | 178,167 |
| Capital Assets Being Depreciated | | | | |
| Buildings | 1,125,329 | - | - | 1,125,329 |
| Machinery and Vehicles | 3,153,838 | 50,240 | 17,670 | 3,186,408 |
| Infrastructure | 427,071 | 1,056,323 | - | 1,483,394 |
| Total Capital Assets Being Depreciated | 4,706,238 | 1,106,563 | 17,670 | 5,795,131 |
| Less: Accumulated Depreciation for: | | | | |
| Buildings | 1,060,662 | 3,908 | - | 1,064,570 |
| Machinery and Vehicles | 1,810,138 | 76,411 | 16,965 | 1,869,584 |
| Infrastructure | 102,197 | 27,027 | - | 129,224 |
| Total Accumulated Depreciation | 2,972,997 | 107,346 | 16,965 | 3,063,378 |
| Total Capital Assets, Depreciated, Net | 1,733,241 | 999,217 | 705 | 2,731,753 |
| Business-Type Activities Capital Assets, Net | \$ 2,007,455 | \$ 1,959,493 | \$ 1,057,028 | \$ 2,909,920 |

**CITY OF PEQUOT LAKES, MINNESOTA
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2016**

NOTE 3 DETAILED NOTES ON ALL FUNDS (CONTINUED)

A. Assets (Continued)

3. Capital Assets (Continued)

In 2016, Depreciation expense was charged to functions/programs of the Primary Government as follows:

| | | |
|--|-----------|----------------|
| Governmental Activities | | |
| General Government | \$ | 66,003 |
| Public Safety | | 86,314 |
| Highways and Streets, Including Depreciation of Infrastructure Assets | | 228,479 |
| Culture and Recreation | | 18,973 |
| Total Depreciation Expense - Governmental Activities | <u>\$</u> | <u>399,769</u> |
| Business-Type Activity | | |
| Water Fund | \$ | 63,765 |
| Sewer Fund | | 43,581 |
| Total Depreciation Expense - Business-Type Activities | <u>\$</u> | <u>107,346</u> |

B. Interfund Receivables and Payables

| Receivable Fund | Payable Fund | Amount |
|-----------------|---------------------------|------------------|
| Business Park | TIF 1-13 Lonesome Cottage | <u>\$ 43,566</u> |

The above payable relates to a negative pooled cash balance.

**CITY OF PEQUOT LAKES, MINNESOTA
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2016**

NOTE 3 DETAILED NOTES ON ALL FUNDS (CONTINUED)

C. Liabilities

1. Long-Term Debt

Loans Payable

The City borrowed \$350,000 of USDA Rural Development funds on March 26, 2014, to provide funds for the acquisition of a fire truck. Repayment of the principal will be fifteen annual installments, plus a fixed interest rate of 3.5%, and began on March 26, 2015.

General Obligation Bonds

The City issues general obligation bonds to provide funds for the acquisition and construction of major capital facilities including infrastructure. General obligation bonds have been issued for both general government and proprietary activities. Bonds issued to provide funds for proprietary activities are reported in proprietary funds if they are expected to be repaid from proprietary revenues.

General obligation bonds are direct obligations and pledge the full faith and credit of the City. Assets of the general fund and the enterprise funds, together with scheduled future ad valorem tax levies, tax increments and special assessments, are dedicated for the retirement of these bonds.

General Obligation Refunding Bonds

On August 9, 2012, the City issued \$1,270,000 in General Obligation Utility Refunding Bonds Series 2012A to currently refund \$1,428,198 on the General Obligation Bonds, Series 2000A and 2000B.

Equipment Certificates

The City issued \$193,000 of equipment certificates on February 18, 2014, to provide funds for the acquisition of a plow truck. Repayment of the principal will be five annual installments, plus a fixed interest rate of 2.5%, and began on February 1, 2015.

Capital Lease Obligations

The City issued a capital lease for the City Hall building. Certain assets of the general fund, together with scheduled future ad valorem levies are dedicated for the retirement of this obligation.

The City entered into a 60-month lease with The Office Shop and Canon Financial Services for the purchase of a Canon Copier. Monthly installments including interest are \$233.

The City entered into a 63-month lease with Hasler Financial for the use of a postage machine. Monthly installments including interest are \$155.

CITY OF PEQUOT LAKES, MINNESOTA
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2016

NOTE 3 DETAILED NOTES ON ALL FUNDS (CONTINUED)

C. Liabilities (Continued)

2. Components of Long-Term Debt

| Types of Indebtedness | Final Maturity | Installment Amounts | Interest Rates (%) | Original Issued Amount | Outstanding Balance December 31, 2016 | Due Within One Year |
|--|----------------|---------------------|--------------------|------------------------|---------------------------------------|---------------------|
| Business-Type Activities | | | | | | |
| Water Fund | | | | | | |
| General Obligation Utility Refunding Bonds of 2012 | 2031 | \$55,000 - \$85,000 | 0.60 - 3.10% | \$ 1,270,000 | \$ 1,030,000 | \$ 60,000 |
| Plus: Unamortized Premium | | | | - | 1,862 | - |
| Capital Leases | | | | | | |
| Water Portion of Postage Lease | 2020 | \$372 | 10.00% | 1,515 | 1,222 | 262 |
| Total Water Fund, Net | | | | \$ 1,271,515 | \$ 1,033,084 | \$ 60,262 |
| Sewer Fund | | | | | | |
| Capital Leases | | | | | | |
| Sewer Portion of Postage Lease | 2020 | \$372 | 10.00% | \$ 1,514 | \$ 1,222 | \$ 262 |
| Total Business-Type Activities Long-Term Debt, Net | | | | \$ 1,273,029 | \$ 1,034,306 | \$ 60,524 |
| Governmental Activities | | | | | | |
| Equipment Certificates, Series 2014A | 2019 | \$37,000- \$40,000 | 2.50% | \$ 193,000 | \$ 118,000 | \$ 38,750 |
| Loans | | | | | | |
| USDA Community Facility Loan | 2029 | \$18,141- \$29,322 | 3.50% | 350,000 | 313,083 | 19,433 |
| Capital Leases | | | | | | |
| Canon Copier | 2018 | \$2,796 | 14.67% | 9,866 | 3,176 | 2,493 |
| City Hall Building | 2024 | \$34,583 | 4.25% | 1,097,442 | 211,046 | 24,005 |
| Government Activities | | | | | | |
| Portion Postage Lease | 2020 | \$1,116 | 10.00% | 4,544 | 3,667 | 785 |
| Total Capital Leases | | | | 1,111,852 | 217,889 | 27,283 |
| Total Governmental Activities Long-Term Debt | | | | 1,654,852 | 648,972 | 85,466 |
| Total Long-Term Debt | | | | \$ 2,927,881 | \$ 1,683,278 | \$ 145,990 |

**CITY OF PEQUOT LAKES, MINNESOTA
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2016**

NOTE 3 DETAILED NOTES ON ALL FUNDS (CONTINUED)

C. Liabilities (Continued)

3. Changes in Long-Term Liabilities

| | Beginning Balance | Additions | Reductions | Ending Balance | Due Within One Year |
|--|----------------------|------------------|-------------------|---------------------|------------------------|
| Governmental Activities: | | | | | |
| Equipment Certificates | \$ 156,000 | \$ - | \$ 38,000 | \$ 118,000 | \$ 38,750 |
| Capital Leases | 243,819 | - | 25,930 | 217,889 | 27,283 |
| Loans Payable | 331,859 | - | 18,776 | 313,083 | 19,433 |
| Compensated Absences | 39,528 | 88,603 | 81,598 | 46,533 | 20,877 |
| Governmental Activities Long-Term Debt | <u>\$ 771,206</u> | <u>\$ 88,603</u> | <u>\$ 164,304</u> | <u>\$ 695,505</u> | <u>\$ 106,343</u> |
| Business-Type Activities: | | | | | |
| General Obligation Refunding Bonds | \$ 1,090,000 | \$ - | \$ 60,000 | \$ 1,030,000 | \$ 60,000 |
| Bond Premium | 1,986 | - | 124 | 1,862 | - |
| Capital Lease | 2,918 | - | 474 | 2,444 | 524 |
| Compensated Absences | 2,490 | 4,566 | 4,384 | 2,672 | 788 |
| Business-Type Activities Long-Term Debt | <u>\$ 1,097,394</u> | <u>\$ 4,566</u> | <u>\$ 64,982</u> | <u>\$ 1,036,978</u> | <u>\$ 61,312</u> |

4. Refunding Debt Issued

During 2012, the City issued General Obligation Utility Refunding Bonds, Series 2012A in the amount of \$1,270,000 with interest rates from 0.6 percent to 3.1 percent, along with \$150,000 of City funds to provide for the current refunding of the General Obligation Bonds Series 2000A and 2000B on October 1, 2012.

**CITY OF PEQUOT LAKES, MINNESOTA
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2016**

NOTE 3 DETAILED NOTES ON ALL FUNDS (CONTINUED)

C. Liabilities (Continued)

5. Minimum Debt Payments

The annual requirements to amortize general obligation debt outstanding are as follows:

| Year Ending December 31, | Business-Type Activities | | | | | |
|-----------------------------|--------------------------|-------------------|---------------------|-----------------|---------------|-----------------|
| | General Obligation | | | Capital Leases | | |
| | Principal | Interest | Total | Principal | Interest | Total |
| 2017 | \$ 60,000 | \$ 23,980 | \$ 83,980 | \$ 524 | \$ 221 | \$ 745 |
| 2018 | 60,000 | 23,320 | 83,320 | 578 | 166 | 744 |
| 2019 | 60,000 | 22,540 | 82,540 | 638 | 106 | 744 |
| 2020 | 60,000 | 21,640 | 81,640 | 704 | 60 | 764 |
| 2021 | 60,000 | 20,620 | 80,620 | - | - | - |
| 2022-2026 | 335,000 | 82,680 | 417,680 | - | - | - |
| 2027-2031 | 395,000 | 31,350 | 426,350 | - | - | - |
| Total | <u>\$ 1,030,000</u> | <u>\$ 226,130</u> | <u>\$ 1,256,130</u> | <u>\$ 2,444</u> | <u>\$ 553</u> | <u>\$ 2,997</u> |

| Year Ending December 31, | Governmental Activities | | | | | |
|-----------------------------|-------------------------|------------------|-------------------|-------------------|------------------|-------------------|
| | Capital Leases | | | Loans | | |
| | Principal | Interest | Total | Principal | Interest | Total |
| 2017 | \$ 27,283 | \$ 8,661 | \$ 35,944 | \$ 19,433 | \$ 10,958 | \$ 30,391 |
| 2018 | 26,533 | 7,317 | 33,850 | 20,113 | 10,278 | 30,391 |
| 2019 | 26,959 | 6,193 | 33,152 | 20,817 | 9,574 | 30,391 |
| 2020 | 28,117 | 5,016 | 33,133 | 21,546 | 8,845 | 30,391 |
| 2021 | 28,162 | 3,851 | 32,013 | 22,300 | 8,091 | 30,391 |
| 2022-2026 | 80,835 | 4,523 | 85,358 | 123,768 | 28,187 | 151,955 |
| 2027-2030 | - | - | - | 85,106 | 6,024 | 91,130 |
| Total | <u>\$ 217,889</u> | <u>\$ 35,561</u> | <u>\$ 253,450</u> | <u>\$ 313,083</u> | <u>\$ 81,957</u> | <u>\$ 395,040</u> |

| Year Ending December 31, | Governmental Activities Equipment Certificates | | |
|-----------------------------|---|-----------------|-------------------|
| | Principal | Interest | Total |
| | 2017 | \$ 38,750 | \$ 2,466 |
| 2018 | 39,250 | 1,491 | 40,741 |
| 2019 | 40,000 | 500 | 40,500 |
| Total | <u>\$ 118,000</u> | <u>\$ 4,457</u> | <u>\$ 122,457</u> |

**CITY OF PEQUOT LAKES, MINNESOTA
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2016**

NOTE 3 DETAILED NOTES ON ALL FUNDS (CONTINUED)

C. Liabilities (Continued)

5. Minimum Debt Payments (Continued)

At year-end, included in capital assets related to these capital leases are assets recorded at \$1,056,200 for the City Hall building, \$9,866 for the copier lease, and \$7,575 for the postage machine lease. There was accumulated depreciation of \$471,518 on the City Hall building, \$6,906 on the copier lease, and \$2,272 on the postage machine lease for 2016.

NOTE 4 RISK MANAGEMENT

The City is exposed to various risks of loss related to: torts; theft of, damage to, or destruction of assets; errors or omissions; injuries to employees; or natural disasters. The City has entered into a joint powers agreement with the League of Minnesota Cities Insurance Trust (LMCIT). The LMCIT is a public entity risk pool currently operating as common risk management and insurance program for Minnesota cities. The agreement for formation of the LMCIT provides that the pool will be self-sustaining through member assessments and will reinsure through commercial companies for claims in excess of reserved amounts for each insured event. The pool can make additional assessments to make the pool self-sustaining. The City has determined that it is not possible to estimate the amount of such additional assessments; however, they are not expected to be material to the financial statements.

The City also carries commercial insurance for certain other risks of loss, including employee health insurance. There were no significant reductions in insurance coverage from the previous year or settlements in excess of insurance coverage for any of the past three fiscal years.

NOTE 5 OTHER POSTEMPLOYMENT BENEFITS

The City provides health insurance benefits for certain retired employees under a single-employer fully-insured plan. The City provides benefits for retirees as required by *Minnesota Statutes* §471.61 subdivision 2b. Active employees who retire from the City when eligible to receive a retirement benefit from the Public Employees Retirement Association (PERA) of Minnesota (or similar plan) and do not participate in any other health benefits program providing coverage similar to that herein described, will be eligible to continue coverage with respect to both themselves and their eligible dependent(s) under the City's health benefits program. Pursuant to the provisions of the plan, retirees are required to pay varying percentages of the total premium cost. As of January 1, 2015, no retirees were receiving health benefits from the City's health plan.

**CITY OF PEQUOT LAKES, MINNESOTA
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2016**

NOTE 5 OTHER POSTEMPLOYMENT BENEFITS (CONTINUED)

1. Annual OPEB Cost and Net OPEB Obligation

The City's annual other postemployment benefit (OPEB) cost is calculated based on the annual required contribution (ARC) of the employer, an amount actuarially determined in accordance with the parameters of GASB Statement No. 45. The ARC represents a level of fund that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed 30 years. The following table shows the components of the City's annual OPEB cost for 2016, the amount actually contributed to the plan, and changes in the City's net OPEB obligation:

| | |
|---------------------------------|--------------------------|
| Annual Required Contribution | \$ 21,033 |
| Interest on Net OPEB Obligation | 6,691 |
| Adjustment to ARC | <u>(10,093)</u> |
| Annual OPEB Cost | 17,631 |
| Contributions During the Year | <u>(358)</u> |
| Increase in Net OPEB Obligation | 17,273 |
| Net OPEB - Beginning of Year | <u>166,623</u> |
| Net OPEB - End of Year | <u><u>\$ 183,896</u></u> |
| | |
| Governmental Activities | \$ 165,891 |
| Business-Type Activities | <u>18,005</u> |
| Total OPEB Payable | <u><u>\$ 183,896</u></u> |

The City's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan and the net OPEB obligation for December 31, 2016, 2015, and 2014 were as follows:

| Year Ended | Annual OPEB Cost | Employer Contribution | Percentage Contributed | Net OPEB Obligation |
|-------------------|---------------------|--------------------------|---------------------------|------------------------|
| December 31, 2016 | \$ 17,606 | \$ 358 | 2.03 % | \$ 183,896 |
| December 31, 2015 | 18,083 | 117 | 0.65 | 166,648 |
| December 31, 2014 | 18,388 | 526 | 2.86 | 148,682 |

2. Funding Status and Funding Progress

The city currently has no assets that have been deposited into an irrevocable trust for future health benefits. Therefore, the actuarial value of assets is zero. No separate stand-alone financial report is issued for this plan.

| Actuarial Valuation Date | Actuarial Value of Assets (a) | Actuarial Accrued Liability (b) | Unfunded Actuarial Accrued Liability (b-a) | Funded Ratio (a/b) | Covered Payroll (c) | UAAL as a Percentage of Covered Payroll ((b-a)/c) |
|--------------------------------|--|--|---|--------------------------|---------------------------|--|
| 1/1/2015 | \$ - | \$ 94,546 | \$ 94,549 | - % | \$ 607,093 | 15.6 % |

**CITY OF PEQUOT LAKES, MINNESOTA
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2016**

NOTE 5 OTHER POSTEMPLOYMENT BENEFITS (CONTINUED)

2. Funding Status and Funding Progress (Continued)

The schedule of funding progress, presented as required supplementary information following the notes to the basic financial statements presents multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

3. Actuarial Methods and Assumptions

Actuarial valuations involve estimates of the value of reported amounts and assumptions about the probability of the occurrence of events far into the future. Examples include assumptions about future employment, mortality, and healthcare cost trends. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future.

Projections of benefits for financial reporting purposes are based on the substantive plan (as understood by the employer and the plan members) and include the types of benefits provided at the time of each valuation. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities, consistent with the long-term perspective of the calculations

In the January 1, 2015 actuarial valuation, the entry age normal actuarial cost method was used. The actuarial assumptions included a 4.00% discount rate, which is based on the estimated long-term investment yield on the general assets of the City using an underlying long-term inflation assumption 2.50%. The annual healthcare cost trend rate is 7.25% initially, reduced incrementally to an ultimate rate of 5.00% after nine years. The unfunded actuarial accrued liability is being amortized as a level dollar amount over a closed 30-year period.

**CITY OF PEQUOT LAKES, MINNESOTA
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2016**

NOTE 6 DEFINED BENEFIT PENSION PLANS

A. Plan Description

The City participates in the following cost-sharing multiple-employer defined benefit pension plans administered by the Public Employees Retirement Association of Minnesota (PERA). PERA's defined benefit pension plans are established and administered in accordance with Minnesota Statutes, Chapters 353 and 356. PERA's defined benefit pension plans are tax qualified plans under Section 401(a) of the Internal Revenue Code.

1. General Employees Retirement Fund (GERF)

All full-time and certain part-time employees of the City are covered by the General Employees Retirement Fund (GERF). GERF members belong to either the Coordinated Plan or the Basic Plan. Coordinated Plan members are covered by Social Security and Basic Plan members are not. The Basic Plan was closed to new members in 1967. All new members must participate in the Coordinated Plan.

2. Public Employees Police and Fire Fund (PEPFF)

The PEPFF, originally established for police officers and firefighters not covered by a local relief association, now covers all police officers and firefighters hired since 1980. Effective July 1, 1999, the PEPFF also covers police officers and firefighters belonging to a local relief association that elected to merge with and transfer assets and administration to PERA.

B. Benefits Provided

PERA provides retirement, disability, and death benefits. Benefit provisions are established by state statute and can only be modified by the state legislature.

Benefit increases are provided to benefit recipients each January. Increases are related to the funding ratio of the plan. Members in plans that are at least 90% funded for two consecutive years are given 2.5% increases. Members in plans that have not exceeded 90% funded, or have fallen below 80%, are given 1% increases.

The benefit provisions stated in the following paragraphs of this section are current provisions and apply to active plan participants. Vested, terminated employees who are entitled to benefits but are not receiving them yet are bound by the provisions in effect at the time they last terminated their public service.

**CITY OF PEQUOT LAKES, MINNESOTA
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2016**

NOTE 6 DEFINED BENEFIT PENSION PLANS (CONTINUED)

B. Benefits Provided (Continued)

1. GERF Benefits

Benefits are based on a member's highest average salary for any five successive years of allowable service, age, and years of credit at termination of service. Two methods are used to compute benefits for PERA's Coordinated and Basic Plan members. The retiring member receives the higher of a step-rate benefit accrual formula (Method 1) or a level accrual formula (Method 2). Under Method 1, the annuity accrual rate for a Basic Plan member is 2.2% of average salary for each of the first ten years of service and 2.7% for each remaining year. The annuity accrual rate for a Coordinated Plan member is 1.2% of average salary for each of the first ten years and 1.7% for each remaining year. Under Method 2, the annuity accrual rate is 2.7% of average salary for Basic Plan members and 1.7% for Coordinated Plan members for each year of service. For members hired prior to July 1, 1989, a full annuity is available when age plus years of service equal 90 and normal retirement age is 65. For members hired on or after July 1, 1989, normal retirement age is the age for unreduced Social Security benefits capped at 66.

2. PEPFF Benefits

Benefits for the PEPFF members first hired after June 30, 2010, but before July 1, 2014, vest on a prorated basis from 50% after five years up to 100% after ten years of credited service. Benefits for PEPFF members first hired after June 30, 2014, vest on a prorated basis from 50% after ten years up to 100% after twenty years of credited service. The annuity accrual rate is 3% of average salary for each year of service. For PEPFF who were first hired prior to July 1, 1989, a full annuity is available when age plus years of service equal at least 90.

**CITY OF PEQUOT LAKES, MINNESOTA
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2016**

NOTE 6 DEFINED BENEFIT PENSION PLANS (CONTINUED)

C. Contributions

Minnesota Statutes Chapter 353 sets the rates for employer and employee contributions. Contribution rates can only be modified by the state legislature.

1. GERF Contributions

Basic Plan members and Coordinated Plan members were required to contribute 9.10% and 6.50%, respectively, of their annual covered salary in calendar year 2016.

The City was required to contribute 11.78% of pay for Basic Plan members and 7.50% for Coordinated Plan members in calendar year 2016. The City contributions to the GERF for the year ended December 31, 2016, were \$24,792. The City contributions were equal to the required contributions as set by state statute.

2. PEPFF Contributions

Plan members were required to contribute 10.8% of their annual covered salary in calendar year 2016. The City was required to contribute 16.20% of pay for PEPFF members in calendar year 2016. The City contributions to the PEPFF for the year ended December 31, 2016, were \$52,387. The City contributions were equal to the required contributions as set by state statute.

D. Pension Costs

1. GERF Pension Costs

At December 31, 2016, the City reported a liability of \$446,573 for its proportionate share of the GERF's net pension liability. The City's net pension liability reflected a reduction due to the State of Minnesota's contribution of \$6 million to the fund in 2016. The State of Minnesota is considered a non-employer contributing entity and the state's contribution meets the definition of a special funding situation. The State of Minnesota's proportionate share of the net pension liability associated with the City totaled \$5,862. The City's net pension liability was measured as of June 30, 2016, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date. The City proportion of the net pension liability was based on the City contributions received by PERA during the measurement period for employer payroll paid dates from July 1, 2015, through June 30, 2016, relative to the total employer contributions received from all of PERA's participating employers. At June 30, 2016, the City proportion was 0.0055% which was a decrease of 0.0006% from its proportionate measured as of June 30, 2015.

For the year ended December 31, 2016, the City recognized pension expense of \$45,548 for its proportionate share of the General Employees Plan's pension expense. In addition, the City recognized an additional \$2,970 as pension expense (and grant revenue) for its proportionate share of the State of Minnesota's contribution of \$6 million to the General Employees Fund.

**CITY OF PEQUOT LAKES, MINNESOTA
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2016**

NOTE 6 DEFINED BENEFIT PENSION PLANS (CONTINUED)

D. Pension Costs (Continued)

1. GERF Pension Costs (Continued)

At December 31, 2016, the City reported its proportionate share of the GERF's deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

| Description | Deferred Outflows of Resources | Deferred Inflows of Resources |
|---|-----------------------------------|----------------------------------|
| Differences Between Expected and Actual Experience | \$ 1,322 | \$ 36,278 |
| Changes in Assumptions | 96,315 | - |
| Net Difference Between Projected and Actual Earnings on Pension Plan Investments | 49,856 | - |
| Changes in Proportion and Differences Between City Contributions and Proportionate Share of Contributions | - | 33,207 |
| City Contributions Made Subsequent to the Measurement Date | 12,531 | - |
| Total | <u>\$ 160,024</u> | <u>\$ 69,485</u> |

\$12,531 reported as deferred outflows of resources related to pensions resulting from City contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ending December 31, 2017. Other amounts reported as deferred outflows and inflows of resources related to pensions will be recognized in pension expense as follows:

| Year Ending December 31, | Pension Expense Amount |
|--------------------------|------------------------------|
| 2017 | \$ 20,010 |
| 2018 | 9,813 |
| 2019 | 32,056 |
| 2020 | 16,129 |

**CITY OF PEQUOT LAKES, MINNESOTA
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2016**

NOTE 6 DEFINED BENEFIT PENSION PLANS (CONTINUED)

D. Pension Costs (Continued)

2. PEPFF Pension Costs

At December 31, 2016, the City reported a liability of \$1,324,347 for its proportionate share of the PEPFF's net pension liability. The net pension liability was measured as of June 30, 2016, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date. The City proportion of the net pension liability was based on the City contributions received by PERA during the measurement period for employer payroll paid dates from July 1, 2015, through June 30, 2016, relative to the total employer contributions received from all of PERA's participating employers. At June 30, 2016, the City proportion was 0.033% which was a decrease of 0.001% from its proportion measured as of June 30, 2015.

For the year ended December 31, 2016, the City recognized pension expense of \$203,373 for its proportionate share of the PEPFF's pension expense. The City also recognized \$2,970 for the year ended December 31, 2016, as pension expense (and grant revenue) for its proportionate share of the State of Minnesota's on-behalf contributions to the PEPFF. Legislation passed in 2013 required the State of Minnesota to begin contributing \$9 million to the PEPFF each year, starting in fiscal year 2014.

At December 31, 2016, the City reported its proportionate share of the PEPFF's deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

| Description | Deferred Outflows of Resources | Deferred Inflows of Resources |
|---|-----------------------------------|----------------------------------|
| Differences Between Expected and Actual Experience | \$ 299 | \$ 151,928 |
| Changes in Assumptions | 782,297 | - |
| Net Difference Between Projected and Actual Earnings on Pension Plan Investments | 114,171 | - |
| Changes in Proportion and Differences Between City Contributions and Proportionate Share of Contributions | 8,943 | 10,875 |
| City Contributions Made Subsequent to the Measurement Date | 26,974 | - |
| Total | <u>\$ 932,684</u> | <u>\$ 162,803</u> |

**CITY OF PEQUOT LAKES, MINNESOTA
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2016**

NOTE 6 DEFINED BENEFIT PENSION PLANS (CONTINUED)

D. Pension Costs (Continued)

2. PEPFF Pension Costs (Continued)

\$26,974 reported as deferred outflows of resources related to pensions resulting from City contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ending December 31, 2017. Other amounts reported as deferred outflows and inflows of resources related to pensions will be recognized in pension expense as follows:

| Year Ending December 31, | Pension Expense Amount |
|--------------------------|------------------------------|
| 2017 | \$ 141,572 |
| 2018 | 141,572 |
| 2019 | 185,538 |
| 2020 | 151,289 |
| 2021 | 122,936 |

E. Actuarial Assumptions

The total pension liability in the June 30, 2016, actuarial valuation was determined using the following actuarial assumptions:

| | |
|------------------------------|----------------|
| Inflation | 2.50% per Year |
| Active Member Payroll Growth | 3.25% per Year |
| Investment Rate of Return | 7.5% |

Salary increases were based on a service-related table. Mortality rates for active members, retirees, survivors and disabilitants were based on RP 2014 tables for the General Employees Plan and RP-2000 tables for the Police and Fire Plan and Correctional Plan for males or females, as appropriate, with slight adjustments. Cost of living benefit increases for retirees are assumed to be: one percent per year for all future years for the General Employees Plan and Police and Fire Plan.

Actuarial assumptions used in the June 30, 2016 valuation were based on the results of actuarial experience studies. The most recent four-year experience study in the General Employees Plan was completed in 2015. The experience study for Police and Fire Plan was for the period July 1, 2004 through June 30, 2009.

The following changes in actuarial assumptions occurred in 2016 for the General Employees Fund:

- The assumed post-retirement benefit increase rate was changed from 1.0% per year through 2035 and 2.5% per year thereafter to 1.0% per year for all future years.
- The assumed investment return was changed from 7.9% to 7.5%. The single discount rate was changed from 7.9% to 7.5%.

**CITY OF PEQUOT LAKES, MINNESOTA
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2016**

NOTE 6 DEFINED BENEFIT PENSION PLANS (CONTINUED)

E. Actuarial Assumptions (Continued)

General Employees Fund (Continued)

- Other assumptions were changed pursuant to the experience study dated June 30, 2015. The assumed future salary increases, payroll growth, and inflation were decreased by 0.25% to 3.25% for payroll growth and 2.50% for inflation.

The following changes in actuarial assumptions occurred in 2016 for the Police and Fire Fund:

- The assumed post-retirement benefit increase rate was changed from 1.0% per year through 2037 and 2.5% thereafter to 1.0% per year for all future years.
- The assumed investment return was changed from 7.9% to 7.5%. The single discount rate changed from 7.9% to 5.6%.
- The assumed future salary increases, payroll growth, and inflation were decreased by 0.25% to 3.25% for payroll growth and 2.50% for inflation.

The State Board of Investment, which manages the investments of PERA, prepares an analysis of the reasonableness on a regular basis of the long-term expected rate of return using a building-block method in which best-estimate ranges of expected future rates of return are developed for each major asset class. These ranges are combined to produce an expected long-term rate of return by weighting the expected future rates of return by the target asset allocation percentages. The target allocation and best estimates of geometric real rates of return for each major asset class are summarized in the following table:

| Asset Class | Target Allocation | Long-Term Expected Real Rate of Return |
|----------------------|-------------------|--|
| Domestic Stocks | 45 % | 5.5 % |
| International Stocks | 15 | 6.0 |
| Bonds | 18 | 1.5 |
| Alternative Assets | 20 | 6.4 |
| Cash | 2 | 0.5 |
| Totals | 100 % | |

F. Discount Rate

The discount rate used to measure the total pension liability in 2016 was 7.50%, a reduction from the 7.9% used in 2015. The projection of cash flows used to determine the discount rate assumed that contributions from plan members and employers will be made at rates set in Minnesota Statutes. Based on these assumptions, the fiduciary net position of the General Employees Fund was projected to be available to make all projected future benefit payments of current plan members. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

**CITY OF PEQUOT LAKES, MINNESOTA
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2016**

NOTE 6 DEFINED BENEFIT PENSION PLANS (CONTINUED)

F. Discount Rate (Continued)

In the Police and Fire Fund, the fiduciary net position was projected to be available to make all projected future benefit payments of current plan members through June 30, 2056 and June 30, 2058 respectively. Beginning in fiscal years ended June 30, 2057 for the Police and Fire Fund, when projected benefit payments exceed the funds' projected fiduciary net position, benefit payments were discounted at the municipal bond rate of 2.85% based on an index of 20-year general obligation bonds with an average AA credit rating at the measurement date. An equivalent single discount rate of 5.60% for the Police and Fire Fund was determined that produced approximately the same present value of projected benefits when applied to all years of projected benefits as the present value of projected benefits using 7.50% applied to all years of projected benefits through the point of asset depletion and 2.85% after.

G. Pension Liability Sensitivity

The following presents the City proportionate share of the net pension liability for all plans it participates in, calculated using the discount rate disclosed in the preceding paragraph, as well as what the City proportionate share of the net pension liability would be if it were calculated using a discount rate one percentage point lower or one percentage point higher than the current discount rate:

| | <u>1% Decrease (6.50%)</u> | <u>Current Discount Rate (7.50%)</u> | <u>1% Increase (8.50%)</u> |
|--|--------------------------------|--|--------------------------------|
| City Proportionate Share of the GERP Net Pension Liability | \$ 634,266 | \$ 446,573 | \$ 291,965 |
| | <u>1% Decrease (4.60%)</u> | <u>Current Discount Rate (5.60%)</u> | <u>1% Increase (6.60%)</u> |
| City Proportionate Share of the PEPFF Net Pension Liability | \$ 1,853,911 | \$ 1,324,347 | \$ 891,654 |

H. Pension Plan Fiduciary Net Position

Detailed information about each pension plan's fiduciary net position is available in a separately-issued PERA financial report that includes financial statements and required supplementary information. That report may be obtained on the Internet at www.mnpera.org.

**CITY OF PEQUOT LAKES, MINNESOTA
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2016**

NOTE 7 DEFINED BENEFIT PENSION PLAN – FIRE RELIEF ASSOCIATION

A. Plan Description

Firefighters of the City are members of the Pequot Lakes Firefighters Relief Association. The Association is the administrator of the single-employer defined benefit pension plan available to firefighters. The plan is administered pursuant to Minnesota Statutes, Chapter 69, Chapter 424A, and the Association's by-laws. As of December 31, 2015, membership includes 30 active participants and 3 terminated employees entitled to benefit but not yet receiving them. The Plan issues a stand-alone financial statement.

B. Benefits Provided

Authority for payment of pension benefits is established in Minnesota Statutes §69.77 and may be amended only by the Minnesota State Legislature. Each member who is at least 50 years of age, has retired from the Fire Department, has served at least 20 years of active service with such department before retirement shall be entitled to a lump sum service pension in the amount of \$3,700 (increased to \$3,900 effective September 6, 2016) for each year of active Fire Department service (including each year over 20) but not exceeding the maximum amount per year of service allowed by law for the minimum average amount of available financing per firefighter as prescribed by law.

Pursuant to Minnesota Statutes §424A.02, Subds. 2 and 4, members who retire with 10 years of service and have reached the age of 50 years are eligible for a retirement benefit. Members who retire before full retirement age and years of service requirements are eligible for a reduced benefit, based on the vesting schedule as set forth in Minnesota Statutes §424A.02, Subd. 2(c). During the time a member is on early vested pension, they will not be eligible for disability benefits.

If a member of the Association shall become permanently or totally disabled, the Association shall pay the sum \$3,700 for each year the member was an active member of the Pequot Lakes Fire Department. If a member who received a disability pension subsequently recovers and returns to active duty, the disability pension is deducted from the service pension. A death benefit is also available, which is payable to a survivor.

Minnesota Statutes §424A.10 provides for the payment of a supplemental benefit equal to 10 percent of a regular lump sum distribution up to a maximum of \$1,000. The supplemental benefit is in lieu of state income tax exclusion for lump sum distributions and will no longer be available if state tax law is modified to exclude lump sum distributions from state income tax. The Association qualifies for these benefits.

**CITY OF PEQUOT LAKES, MINNESOTA
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2016**

NOTE 7 DEFINED BENEFIT PENSION PLAN – FIRE RELIEF ASSOCIATION (CONTINUED)

C. Contributions

Minnesota Statutes Chapter 69.772 specifies minimum support rates required on an annual basis. The minimum support rates from the municipality and from state aid are determined as the amount required to meet the normal cost plus amortizing any existing prior service costs over a 10-year period. The significant actuarial assumptions used to compute the municipal support are the same as those used to compute the accrued pension liability. The association is comprised of volunteers; therefore, there are no payroll expenditures (i.e. there are no covered payroll percentage calculations). The minimum contribution from the City and state aid is determined as follows:

| | | |
|---|--|--|
| | Normal Cost | |
| + | Amortization Payment on Unfunded Accrued Liability Prior to Any Change | |
| + | Amortization Contribution on Unfunded Accrued Liability Attributed to Any Change | |
| + | Administrative Expenses | |
| - | Anticipated State Aid | |
| - | Projected Investment Earnings | |
| = | Total Contribution Required | |
| | | |

The Plan is funded in part by fire state aid and, if necessary, City contributions. The State of Minnesota distributed to the City \$48,895 in fire state aid paid by the City to the Relief Association for the year ended December 31, 2016. Required employer contributions are calculated annually based on statutory provisions. For the year ended December 31, 2016, there was no statutorily-required City contribution to the plan.

D. Pension Costs

At December 31, 2015, the most current information available, the City reported an asset of \$336,750 for the Association's net pension asset. The net pension asset was measured as of December 31, 2015, and the total pension asset used to calculate the net pension asset was determined by an actuarial valuation as of that date.

As a result of its requirement to contribute to the Relief Association, the City recognized expense of \$70,113 for the year ended December 31, 2016. At December 31, 2016, the City reported deferred outflows of resources and deferred inflows of resources from the following sources:

| Description | Deferred Outflows of Resources | Deferred Inflows of Resources |
|--|--------------------------------------|-------------------------------------|
| Differences Between Expected and Actual Economic Experience | \$ - | \$ - |
| Changes in Actuarial Assumptions | - | - |
| Net Difference Between Projected and Actual Earnings on Pension Plan Investments | 23,734 | - |
| City Contributions Subsequent to the Measurement Date | 51,311 | - |
| Total | \$ 75,045 | \$ - |

**CITY OF PEQUOT LAKES, MINNESOTA
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2016**

NOTE 7 DEFINED BENEFIT PENSION PLAN – FIRE RELIEF ASSOCIATION (CONTINUED)

D. Pension Costs (Continued)

The City contributions to the Association subsequent to the measurement date, \$51,311 reported as deferred outflows of resources will be recognized as a reduction of the net pension liability in the year ending December 31, 2017. Other amounts reported as deferred outflows and inflows of resources related to the Association’s pension will be recognized in pension expense as follows:

| Year Ending December 31, | Pension Expense Amount |
|--------------------------|------------------------------|
| 2017 | \$ 4,977 |
| 2018 | 4,977 |
| 2019 | 4,977 |
| 2020 | 8,803 |

E. Actuarial Assumptions

The actuarial total pension liability was determined as of December 31, 2015, using the following actuarial assumptions, applied to all periods included in the measurement:

| | |
|------------------------------|------------------------|
| Valuation Date | December 31, 2015 |
| Actuarial Cost Method | Entry Age Normal |
| Amortization Method | Level Dollar Closed |
| Actuarial Assumptions: | |
| Discount Rate | 4.00% |
| Investment Rate of Return | 4.00% |
| 20-Year Municipal Bond Yield | 3.50% |
| Age of Service Retirement | 50 |

The best-estimate of expected future real rates of return were developed by aggregating data from several published capital market assumption surveys and deriving a single best-estimate based on the average survey values. These capital market assumptions reflect both historical market experience as well as diverse views regarding anticipated future returns. The expected inflation assumption was developed based on an analysis of historical experience blended with forward-looking expectations available in market data.

**CITY OF PEQUOT LAKES, MINNESOTA
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2016**

NOTE 7 DEFINED BENEFIT PENSION PLAN – FIRE RELIEF ASSOCIATION (CONTINUED)

E. Actuarial Assumptions (Continued)

Best estimates of geometric real and nominal rates of return for each major asset class included in the pension plan's asset allocation as of December 31, 2015 are summarized in the following table:

| Asset Class | Allocation at December 31, 2015 | Long-Term Expected Real Rate of Return |
|------------------|---------------------------------------|--|
| Cash Equivalents | 46.00 % | 2.00 % |
| Fixed Income | 25.00 | 4.00 |
| Equities | 29.00 | 7.50 |
| Total Portfolio | <u>100.00 %</u> | |

F. Discount Rate

The discount rate used to measure the total pension liability was 4.00%. Assets were projected using expected benefit payments and expected asset returns. Expected benefit payments were discounted by year using expected assets return assumption for years in which the assets were sufficient to pay all benefit payments. Any remaining benefit payments after the trust fund is exhausted are discounted at the municipal bond rate of return. The equivalent single rate is the discount rate. Based on those assumptions, the pension plan's fiduciary net position was projected to be available to make all projected future benefit payments of current plan members.

G. Pension Asset Sensitivity

The following presents the City's proportionate share of the net pension asset of the Association, calculated using the discount rate of 4.00%, as well as what the Association's net pension liability would be if it were calculated using a discount rate that is one percentage point lower (3.00%) or one percentage point higher (5.00%) than the current rate:

| | 1% Decrease (3.00%) | Current Discount Rate (4.00%) | 1% Increase (5.00%) |
|-------------------------------|------------------------|----------------------------------|------------------------|
| Net Pension Liability (Asset) | \$ (314,440) | \$ (336,750) | \$ (358,178) |

**CITY OF PEQUOT LAKES, MINNESOTA
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2016**

NOTE 7 DEFINED BENEFIT PENSION PLAN – FIRE RELIEF ASSOCIATION (CONTINUED)

H. Plan’s Fiduciary Net Position

Information about the Plan’s fiduciary net position is as follows:

| | <u>Measurement Date December 31, 2015</u> |
|---|---|
| <u>Total Pension Liability</u> | |
| Service Cost | \$ 52,224 |
| Interest | 38,947 |
| Plan Changes | 58,442 |
| Benefit Payments, Including Member Refunds | <u>(72,167)</u> |
| Net Change in Total Pension Liability | 77,446 |
| | |
| Total Pension Liability - Beginning | <u>1,009,761</u> |
| Total Pension Liability - Ending (a) | 1,087,207 |
| | |
| <u>Plan Fiduciary Net Position</u> | |
| Municipal Contributions | 48,305 |
| State Contributions | 48,895 |
| Net Investment Income | 12,056 |
| Benefit Payments | (72,167) |
| Administrative Expenses | <u>(5,185)</u> |
| Net Change in Fiduciary Net Position | 31,904 |
| | |
| Fiduciary Net Position - Beginning | <u>1,392,053</u> |
| Fiduciary Net Position - Ending (b) | 1,423,957 |
| | |
| Association's Net Pension Liability/(Asset) - Ending (a) - (b) | <u>\$ (336,750)</u> |

Detailed information about the pension plan’s fiduciary net position is available in a separately-issued financial report that includes financial statements and required supplementary information. That report may be obtained by calling Pequot Lakes City Hall at (218)-568-5222.

**CITY OF PEQUOT LAKES, MINNESOTA
 NOTES TO THE FINANCIAL STATEMENTS
 DECEMBER 31, 2016**

NOTE 8 DEFINED CONTRIBUTION PLAN

One elected official of the City is covered by the Defined Contribution Plan, a multiple-employer deferred compensation plan administered by PERA. The Defined Contribution Plan is a tax qualified plan under Section 401(a) of the Internal Revenue Code and all contributions by or on behalf of employees are tax deferred until time of withdrawal.

Plan benefits depend solely on amounts contributed to the plan plus investment earnings, less administrative expenses. *Minnesota Statutes*, Chapter 353D.03, specifies plan provisions, including the employee and employer contribution rates for those qualified personnel who elect to participate. An eligible elected official who decides to participate contributes five percent of salary which is matched by the elected official's employer. For ambulance service personnel, employer contributions are determined by the employer, and for salaried employees contributions must be a fixed percentage of salary. Employer contributions for volunteer personnel may be a unit value for each call or period of alert duty. Employees who are paid for their services may elect to make member contributions in an amount not to exceed the employer share. Employer and employee contributions are combined and used to purchase shares in one or more of the seven accounts of the Minnesota Supplemental Investment Fund. For administering the plan, PERA receives two percent of employer contributions and twenty-five hundredths of one percent (0.0025) of the assets in each member's account annually.

Total contributions made by the City during fiscal year 2016 were:

| Contribution Amount | | Percentage of Covered Payroll | | Required |
|---------------------|----------|-------------------------------|----------|----------|
| Employee | Employer | Employee | Employer | Rate |
| \$ 199 | \$ 199 | 5.0 % | 5.0 % | 5.0 % |

NOTE 9 RELATED-ORGANIZATION

The Pequot Lakes Fire Relief Association (the Association) is excluded from the financial reporting entity because the City's financial accountability does not extend beyond making appointments. The purpose of the Association is to provide lump-sum retirement benefits for City firefighters. The City has no significant influence over the management, budget, or policies of the association. Audited financial statements are available from the Association.

**CITY OF PEQUOT LAKES, MINNESOTA
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2016**

NOTE 10 TAX ABATEMENTS

The City entered into a property tax abatement agreement with a local business to promote job development and to increase the tax base as authorized under Minnesota Statutes §469.1812 to 469.1815. The City entered into the agreement during 2012 to abate property taxes for a period of 13 years or up to \$350,000. To be eligible for abated property taxes, the Developer needed to construct a grocery store, commercial facility, potential gas island, and associated parking along Highway 371 being approximately 33,000 square feet. Within two years of the benefit date, the Developer will also create at least ten (10) new full-time equivalent jobs at a wage of at least 175% of the federal minimum wage in effect at the time, which includes benefits. If none of the goals are met, the developer shall repay all of the previously abated property taxes, plus interest set at the implicit price deflator. If the goals are met in part, the Developer will repay a portion of the previously abated property taxes. For the year ended December 31, 2016, the City abated taxes totaling \$18,201. No other commitments were made by the City as part of that agreement.

The City has two pay-as-you-go tax increment financing districts with local businesses to promote economic development within the City as authorized under Minnesota Statute §469.174. The City is currently collecting tax increments that are paid through the property tax collection process. One of these districts stops collections as of December 31, 2017, and the second will stop collections as of December 31, 2018. The requirement for businesses to receive the excess tax increments from the City is to perform improvements on the owned property. The increment taxes are based on the increase of the property value after the improvements are made. The agreements call for 90% of the property tax increments collected to be returned to the developers. For the year ended December 31, 2016, the City paid excess tax increment in the amount of \$26,330. No other commitments were made by the City as part of these agreements.

REQUIRED SUPPLEMENTARY INFORMATION OTHER THAN MD&A

**CITY OF PEQUOT LAKES, MINNESOTA
BUDGETARY COMPARISON SCHEDULE
GENERAL FUND
YEAR ENDED DECEMBER 31, 2016**

| | Budgeted Amounts | | Actual Amounts | Variance with Final Budget |
|-------------------------------|------------------|--------------|-------------------|-------------------------------|
| | Original | Final | | |
| REVENUES | | | | |
| Taxes | \$ 1,501,767 | \$ 1,501,767 | \$ 1,563,406 | \$ 61,639 |
| Special Assessments | 500 | 500 | 580 | 80 |
| Licenses and Permits | 14,500 | 14,500 | 15,445 | 945 |
| Intergovernmental | 93,600 | 93,600 | 101,347 | 7,747 |
| Charges for Services | 120,720 | 120,720 | 128,463 | 7,743 |
| Fines and Forfeits | 13,500 | 13,500 | 16,546 | 3,046 |
| Gifts and Contributions | 16,500 | 16,500 | 65,482 | 48,982 |
| Investment Earnings | 22,500 | 22,500 | 11,263 | (11,237) |
| Miscellaneous | 20,300 | 20,300 | 69,146 | 48,846 |
| Total Revenues | 1,803,887 | 1,803,887 | 1,971,678 | 167,791 |
| EXPENDITURES | | | | |
| CURRENT | | | | |
| GENERAL GOVERNMENT | | | | |
| Council | 26,840 | 26,840 | 30,989 | (4,149) |
| Clerk | 228,640 | 228,640 | 228,605 | 35 |
| Planning and Zoning | 83,730 | 83,730 | 69,111 | 14,619 |
| Buildings and Plant | 50,460 | 50,460 | 43,046 | 7,414 |
| Other General Government | 114,150 | 114,150 | 95,875 | 18,275 |
| Total General Government | 503,820 | 503,820 | 467,626 | 36,194 |
| PUBLIC SAFETY | | | | |
| Police | 585,640 | 585,640 | 613,088 | (27,448) |
| Fire | 89,600 | 89,600 | 88,939 | 661 |
| Civil Defense | 1,900 | 1,900 | 406 | 1,494 |
| Total Public Safety | 677,140 | 677,140 | 702,433 | (25,293) |
| HIGHWAYS AND STREETS | | | | |
| Public Works | 288,430 | 288,430 | 327,508 | (39,078) |
| Street Lighting | 17,900 | 17,900 | 15,064 | 2,836 |
| Traffic Signs and Signals | 4,300 | 4,300 | 2,781 | 1,519 |
| Total Highways and Streets | 310,630 | 310,630 | 345,353 | (34,723) |
| SANITATION | | | | |
| Recycling | 10,000 | 10,000 | 9,468 | 532 |
| CULTURE AND RECREATION | | | | |
| Parks | 22,600 | 22,600 | 28,196 | (5,596) |
| Regional Library | 20,000 | 20,000 | 21,885 | (1,885) |
| Total Culture and Recreation | 42,600 | 42,600 | 50,081 | (7,481) |

The Notes to the Required Supplementary Information are an Integral Part of this Schedule.

**CITY OF PEQUOT LAKES, MINNESOTA
BUDGETARY COMPARISON SCHEDULE
GENERAL FUND (CONTINUED)
YEAR ENDED DECEMBER 31, 2016**

| | Budgeted Amounts | | Actual Amounts | Variance with Final Budget |
|--|--------------------|--------------------|---------------------|-------------------------------|
| | Original | Final | | |
| EXPENDITURES (CONTINUED) | | | | |
| CURRENT (CONTINUED) | | | | |
| ECONOMIC DEVELOPMENT | | | | |
| Housing and Redevelopment Authority | \$ 32,877 | \$ 32,877 | \$ 48,490 | \$ (15,613) |
| CAPITAL OUTLAY | | | | |
| General Government | 16,500 | 16,500 | 12,289 | 4,211 |
| Public Safety | 43,000 | 43,000 | 76,575 | (33,575) |
| Highways and Streets | 165,000 | 165,000 | 185,874 | (20,874) |
| Culture and Recreation | 29,000 | 29,000 | 51,456 | (22,456) |
| Total Capital Outlay | 253,500 | 253,500 | 326,194 | (72,694) |
| DEBT SERVICE | | | | |
| Principal | 23,070 | 23,070 | 23,065 | 5 |
| Interest | 8,950 | 8,950 | 8,945 | 5 |
| Total Debt Service | 32,020 | 32,020 | 32,010 | 10 |
| Total Expenditures | 1,862,587 | 1,862,587 | 1,981,655 | (119,068) |
| EXCESS (DEFICIENCY) OF REVENUES OVER (UNDER) EXPENDITURES | (58,700) | (58,700) | (9,977) | 48,723 |
| OTHER FINANCING SOURCES (USES) | | | | |
| Proceeds from Sale of Assets | 4,000 | 4,000 | 16,844 | 12,844 |
| NET CHANGE IN FUND BALANCE | <u>\$ (54,700)</u> | <u>\$ (54,700)</u> | 6,867 | <u>\$ 61,567</u> |
| Fund Balance - Beginning of Year | | | 1,361,765 | |
| FUND BALANCE - END OF YEAR | | | <u>\$ 1,368,632</u> | |

**CITY OF PEQUOT LAKES, MINNESOTA
BUDGETARY COMPARISON SCHEDULE
FIRE DEPARTMENT SPECIAL REVENUE FUND
YEAR ENDED DECEMBER 31, 2016**

| | <u>Budgeted Amounts</u> | | <u>Actual Amounts</u> | <u>Variance with Final Budget</u> |
|-----------------------------------|-------------------------|-------------------|---------------------------|---------------------------------------|
| | <u>Original</u> | <u>Final</u> | | |
| REVENUES | | | | |
| Intergovernmental | \$ - | \$ - | \$ 79,577 | \$ 79,577 |
| Charges for Services | 198,880 | 198,880 | 193,560 | (5,320) |
| Gifts and Contributions | - | - | 3,706 | 3,706 |
| Investments Earnings | 2,500 | 2,500 | - | (2,500) |
| Miscellaneous | 8,700 | 8,700 | 37,460 | 28,760 |
| Total Revenues | <u>210,080</u> | <u>210,080</u> | <u>314,303</u> | <u>104,223</u> |
| EXPENDITURES | | | | |
| CURRENT | | | | |
| Public Safety | | | | |
| Fire | 133,540 | 133,540 | 182,965 | (49,425) |
| CAPITAL OUTLAY | | | | |
| Public Safety | 29,000 | 29,000 | 80,836 | (51,836) |
| DEBT SERVICE | | | | |
| Principal | 33,380 | 33,380 | 18,776 | 14,604 |
| Interest | 15,320 | 15,320 | 11,615 | 3,705 |
| Total Debt Service | <u>48,700</u> | <u>48,700</u> | <u>30,391</u> | <u>18,309</u> |
| Total Expenditures | <u>211,240</u> | <u>211,240</u> | <u>294,192</u> | <u>(82,952)</u> |
| NET CHANGE IN FUND BALANCE | <u>\$ (1,160)</u> | <u>\$ (1,160)</u> | 20,111 | <u>\$ 21,271</u> |
| Fund Balance - Beginning of Year | | | <u>72,738</u> | |
| FUND BALANCE - END OF YEAR | | | <u>\$ 92,849</u> | |

The Notes to the Required Supplementary Information are an Integral Part of this Schedule.

**CITY OF PEQUOT LAKES, MINNESOTA
NOTES TO THE REQUIRED SUPPLEMENTARY INFORMATION
DECEMBER 31, 2016**

I. BUDGETARY INFORMATION

The City follows these procedures in establishing the budgetary data reflected in the financial statements:

- a. Prior to September 1, the City Administrator/Clerk submits to the City Council a proposed operating budget for the fiscal year commencing the following January 1. The operating budget includes proposed expenditures and the means of financing them. The City Council adopts the proposed budget as amended and adjusted by the Council and certifies the proposed property tax levy to the County Auditor according to Minnesota Statutes.
- b. Public hearings are conducted in the Council's chambers.
- c. On or before December 28, the final budget is legally enacted by Council resolution and the final property tax levy certified to the County Auditor.
- d. Management is authorized to transfer budgeted amounts between departments within any fund; however, any revisions that alter the total expenditures of any fund must be approved by the City Council. Reported budget amounts are as originally adopted or amended by the City Council.
- e. The City has legally adopted budgets for the general fund and the fire fund special revenue fund. Expenditures may not legally exceed budgeted appropriations at the total fund level. Monitoring of budgets is maintained at the expenditure category level (i.e., personal services, supplies, charges for services, and capital outlay) within each program. All amounts over budget have been approved by the City Council through the disbursement process.
- f. Budgets for the general, and certain special revenue funds are adopted on a basis consistent with generally accepted accounting principles. Budgeted amounts are as originally adopted, or as amended by the city council. All annual appropriations lapse at fiscal year-end.

II. EXPENDITURES IN EXCESS OF BUDGET

In the following funds, expenditures exceeded the appropriations during the year ended December 31, 2016:

| | Expenditures | Budget | Excess |
|------------------------|--------------|--------------|------------|
| General Fund | \$ 1,981,655 | \$ 1,862,587 | \$ 119,068 |
| Special Revenue Funds: | | | |
| Fire Fund | 294,192 | 211,240 | 82,952 |

The overages were considered by the City's management to be the result of necessary expenditures critical to operations and were approved by the council.

**CITY OF PEQUOT LAKES, MINNESOTA
 SCHEDULE OF FUNDING PROGRESS
 OTHER POSTEMPLOYMENT BENEFITS
 DECEMBER 31, 2016**

| Actuarial Valuation Date | Actuarial Value of Assets (a) | Actuarial Accrued Liability (b) | Unfunded Actuarial Accrued Liability (b-a) | Funded Ratio (a/b) | Covered Payroll (c) | UAAL as a Percentage of Covered Payroll ((b-a)/c) |
|--------------------------------|--|--|---|--------------------------|---------------------------|--|
| 1/1/2015 | \$ - | \$ 94,546 | \$ 94,549 | - % | \$ 607,093 | 15.6 % |
| 1/1/2012 | - | 105,338 | 105,338 | - | 580,558 | 18.1 |
| 1/1/2009 | - | 118,698 | 118,698 | - | 616,864 | 19.2 |

**CITY OF PEQUOT LAKES, MINNESOTA
PEQUOT LAKES FIREMAN'S RELIEF ASSOCIATION
SCHEDULE OF CHANGES IN THE NET PENSION LIABILITY (ASSET) AND RELATED RATIOS**

| | <u>Measurement Date December 31, 2015</u> | <u>Measurement Date December 31, 2014</u> |
|---|---|---|
| <u>Total Pension Liability</u> | | |
| Service Cost | \$ 52,224 | \$ 48,196 |
| Interest | 38,947 | 36,930 |
| Plan Changes | 58,442 | - |
| Benefit Payments, Including Member Refunds | <u>(72,167)</u> | <u>(78,000)</u> |
| Net Change in Total Pension Liability | 77,446 | 7,126 |
| Total Pension Liability - Beginning | <u>1,009,761</u> | <u>1,002,635</u> |
| Total Pension Liability - Ending (a) | 1,087,207 | 1,009,761 |
| | | |
| <u>Plan Fiduciary Net Position</u> | | |
| Municipal Contributions | 48,305 | 46,629 |
| State Contributions | 48,895 | 48,390 |
| Net Investment Income | 12,056 | 71,726 |
| Benefit Payments | (72,167) | (78,000) |
| Administrative Expenses | <u>(5,185)</u> | <u>(5,670)</u> |
| Net Change in Fiduciary Net Position | 31,904 | 83,075 |
| | | |
| Fiduciary Net Position - Beginning | <u>1,392,053</u> | <u>1,308,978</u> |
| Fiduciary Net Position - Ending (b) | 1,423,957 | 1,392,053 |
| | | |
| Association's Net Pension Liability/(Asset) - Ending (a) - (b) | <u>\$ (336,750)</u> | <u>\$ (382,292)</u> |
| | | |
| Fiduciary Net Position as a Percentage of the Total Pension Asset | 130.97% | 137.86% |
| Covered-Employee Payroll | N/A | N/A |
| Net Pension Liability/(Asset) as a Percentage of Covered-Employee Payroll | N/A | N/A |
| | | |
| Note: Information is required to be presented for 10 years. However, until a full 10-year trend is compiled, the City will present information for only those years for which information is available. | | |

**CITY OF PEQUOT LAKES, MINNESOTA
SCHEDULE OF THE CITY'S PROPORTIONATE SHARE
OF THE NET PENSION LIABILITY (ASSET)**

| | <u>Measurement Date</u> June 30, 2016 | <u>Measurement Date</u> June 30, 2015 |
|---|--|--|
| PERA - GERS - City | | |
| City's Proportion of the Net Pension Liability | 0.0055% | 0.0063% |
| City's Proportionate Share of the Net Pension Liability | \$ 446,573 | \$ 326,499 |
| State's Proportionate Share of the Net Pension Liability Associated with the City | \$ 2,970 | - |
| City's Covered-Employee Payroll | \$ 342,732 | \$ 369,980 |
| City's Proportionate Share of the Net Pension Liability as a Percentage of Its Covered-Employee Payroll | 130.30% | 88.25% |
| Plan Fiduciary Net Position as a Percentage of the Total Pension Liability | 68.90% | 78.20% |
| PERA - PEPFF - City | | |
| City's Proportion of the Net Pension Liability | 0.0330% | 0.0340% |
| City's Proportionate Share of the Net Pension Liability | \$ 1,324,347 | \$ 386,320 |
| City's Covered-Employee Payroll | \$ 318,651 | \$ 311,104 |
| City's Proportionate Share of the Net Pension Liability as a Percentage of Its Covered-Employee Payroll | 415.61% | 124.18% |
| Plan Fiduciary Net Position as a Percentage of the Total Pension Liability | 63.90% | 82.30% |
| | <u>Measurement Date</u> December 31, 2015 | <u>Measurement Date</u> December 31, 2014 |
| Fire Relief Association | | |
| City's Proportion of the Net Pension Liability (Asset) | 100.0000% | 100.0000% |
| City's Proportionate Share of the Net Pension Liability (Asset) | \$ (336,750) | \$ (382,292) |
| City's Covered-Employee Payroll | N/A | N/A |
| City's Proportionate Share of the Net Pension Liability (Asset) as a Percentage of Its Covered-Employee Payroll | N/A | N/A |
| Plan Fiduciary Net Position as a Percentage of the Total Pension Liability | 130.97% | 137.86% |

Note: Information is required to be presented for 10 years. However, until a full 10-year trend is compiled, the City will present information for only those years for which information is available.

**CITY OF PEQUOT LAKES, MINNESOTA
SCHEDULE OF CITY PENSION CONTRIBUTIONS**

| | <u>2016</u> | <u>2015</u> | <u>2014</u> |
|--|-------------|-------------|-------------|
| PERA - GERF - City | | | |
| Contractually Required Contribution | \$ 24,792 | \$ 27,566 | \$ 25,559 |
| Contributions in Relation to the Contractually Required Contribution | (24,792) | (27,566) | (25,559) |
| Contribution Deficiency (Excess) | <u>\$ -</u> | <u>\$ -</u> | <u>\$ -</u> |
| City's Covered-Employee Payroll | \$ 330,560 | \$ 367,547 | \$ 352,531 |
| Contributions as a Percentage of Covered Employee Payroll | 7.50% | 7.50% | 7.25% |
| PERA - PEPFF - City | | | |
| Contractually Required Contribution | \$ 52,387 | \$ 50,492 | \$ 47,017 |
| Contributions in Relation to the Contractually Required Contribution | (52,387) | (50,492) | (47,017) |
| Contribution Deficiency (Excess) | <u>\$ -</u> | <u>\$ -</u> | <u>\$ -</u> |
| City's Covered-Employee Payroll | \$ 323,378 | \$ 311,680 | \$ 307,297 |
| Contributions as a Percentage of Covered Employee Payroll | 16.20% | 16.20% | 15.30% |
| Fire Relief Association | | | |
| Statutorily Required Contribution | \$ - | \$ - | \$ - |
| Contributions in Relation to the Statutorily Required Contribution | - | - | - |
| Contribution Deficiency (Excess) | <u>\$ -</u> | <u>\$ -</u> | <u>\$ -</u> |
| City's Covered-Employee Payroll | N/A | N/A | N/A |
| Contributions as a Percentage of Covered Employee Payroll | N/A | N/A | N/A |

Note: Information is required to be presented for 10 years. However, until a full 10-year trend is compiled, the City will present information for only those years for which information is available.

This Page Has Been Intentionally Left Blank.

SUPPLEMENTARY INFORMATION

**CITY OF PEQUOT LAKES, MINNESOTA
 COMBINING BALANCE SHEET
 NONMAJOR GOVERNMENTAL FUNDS
 DECEMBER 31, 2016**

| | Cemetery Perpetual Care | TIF 1-9 Lime Greenery | TIF 1-13 Lonesome Cottage |
|---|----------------------------|--------------------------|---------------------------------|
| ASSETS | | | |
| Cash and Investments | \$ 63,945 | \$ 1,790 | \$ - |
| Taxes Receivable | | | |
| Current | - | - | - |
| Total Assets | \$ 63,945 | \$ 1,790 | \$ - |
| LIABILITIES AND FUND BALANCES (DEFICITS) | | | |
| LIABILITIES | | | |
| Accounts Payable | \$ - | \$ 1,673 | \$ 11,492 |
| Due to Other Funds | - | - | 43,566 |
| Total Liabilities | - | 1,673 | 55,058 |
| FUND BALANCES (DEFICITS) | | | |
| Restricted for Economic Development | - | 117 | - |
| Restricted for Debt Repayment | - | - | - |
| Committed for Cemetery Perpetual Care | 63,945 | - | - |
| Unassigned | - | - | (55,058) |
| Total Fund Balances (Deficits) | 63,945 | 117 | (55,058) |
| Total Liabilities and Fund Balances (Deficits) | \$ 63,945 | \$ 1,790 | \$ - |

| Total Nonmajor Special Revenue Funds | 2014 Equipment Certificates | 2010 Equipment Certificates | Total Nonmajor Debt Service Funds | Total Nonmajor Governmental Funds |
|--|-----------------------------------|-----------------------------------|---|---|
| \$ 65,735 | \$ 43,659 | \$ - | \$ 43,659 | \$ 109,394 |
| - | 1,742 | 41 | 1,783 | 1,783 |
| <u>\$ 65,735</u> | <u>\$ 45,401</u> | <u>\$ 41</u> | <u>\$ 45,442</u> | <u>\$ 111,177</u> |
| \$ 13,165 | \$ - | \$ - | \$ - | \$ 13,165 |
| 43,566 | - | - | - | 43,566 |
| <u>56,731</u> | <u>-</u> | <u>-</u> | <u>-</u> | <u>56,731</u> |
| 117 | - | - | - | 117 |
| - | 45,401 | 41 | 45,442 | 45,442 |
| 63,945 | - | - | - | 63,945 |
| (55,058) | - | - | - | (55,058) |
| <u>9,004</u> | <u>45,401</u> | <u>41</u> | <u>45,442</u> | <u>54,446</u> |
| <u>\$ 65,735</u> | <u>\$ 45,401</u> | <u>\$ 41</u> | <u>\$ 45,442</u> | <u>\$ 111,177</u> |

CITY OF PEQUOT LAKES, MINNESOTA
COMBINING STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND
BALANCES
NONMAJOR GOVERNMENTAL FUNDS
YEAR ENDED DECEMBER 31, 2016

| | Cemetery Perpetual Care | TIF 1-9 Lime Greenery | TIF 1-13 Lonesome Cottage |
|--|----------------------------|--------------------------|---------------------------------|
| REVENUES | | | |
| Taxes | \$ - | \$ 3,717 | \$ 25,538 |
| Charges for Services | 2,800 | - | - |
| Investment Earnings | 327 | 8 | - |
| Miscellaneous | 17 | - | - |
| Total Revenues | 3,144 | 3,725 | 25,538 |
| EXPENDITURES | | | |
| CURRENT | | | |
| General Government | 225 | - | - |
| Public Safety | - | - | - |
| Economic Development | - | 4,891 | 25,363 |
| CAPITAL OUTLAY | | | |
| Public Safety | - | - | - |
| DEBT SERVICE | | | |
| Principal | - | - | - |
| Interest | - | - | - |
| Total Expenditures | 225 | 4,891 | 25,363 |
| EXCESS (DEFICIENCY) OF REVENUES OVER (UNDER) EXPENDITURES | 2,919 | (1,166) | 175 |
| Fund Balance (Deficit) - Beginning of Year | 61,026 | 1,283 | (55,233) |
| FUND BALANCE (DEFICIT) - END OF YEAR | \$ 63,945 | \$ 117 | \$ (55,058) |

| Total Nonmajor Special Revenue Funds | 2014 Equipment Certificates | 2010 Equipment Certificates | Total Nonmajor Debt Service Funds | Total Nonmajor Governmental Funds |
|--|-----------------------------------|-----------------------------------|---|---|
| \$ 29,255 | \$ 43,430 | \$ 1,208 | \$ 44,638 | \$ 73,893 |
| 2,800 | - | - | - | 2,800 |
| 335 | - | - | - | 335 |
| 17 | - | - | - | 17 |
| <u>32,407</u> | <u>43,430</u> | <u>1,208</u> | <u>44,638</u> | <u>77,045</u> |
| 225 | - | - | - | 225 |
| - | - | 10 | 10 | 10 |
| 30,254 | - | - | - | 30,254 |
| - | - | 1,397 | 1,397 | 1,397 |
| - | 38,000 | - | 38,000 | 38,000 |
| - | 3,627 | - | 3,627 | 3,627 |
| <u>30,479</u> | <u>41,627</u> | <u>1,407</u> | <u>43,034</u> | <u>73,513</u> |
| 1,928 | 1,803 | (199) | 1,604 | 3,532 |
| <u>7,076</u> | <u>43,598</u> | <u>240</u> | <u>43,838</u> | <u>50,914</u> |
| <u>\$ 9,004</u> | <u>\$ 45,401</u> | <u>\$ 41</u> | <u>\$ 45,442</u> | <u>\$ 54,446</u> |

This Page Has Been Intentionally Left Blank.

REPORTS RELATED TO *GOVERNMENT AUDITING STANDARDS*



**INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER
FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS
BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED
IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

Honorable Mayor and
Members of the City Council
City of Pequot Lakes
Pequot Lakes, Minnesota

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Pequot Lakes (the City), Minnesota, as of and for the year ended December 31, 2016, and the related notes to the financial statements, which collectively comprise the City's basic financial statements and have issued our report thereon dated April 21, 2017.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the City's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control. Accordingly, we do not express an opinion on the effectiveness of the City's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying Schedule of Findings and Recommendations, we identified certain deficiencies in internal control that we consider to be a material weakness and significant deficiency.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the City's financial statements will not be prevented, or detected and corrected on a timely basis. We consider deficiency 2016-001 described in the accompanying schedule of findings and recommendations to be a material weakness.

A *significant deficiency* is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider deficiency 2016-002 as described in the accompanying schedule of findings and recommendations to be a significant deficiency.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the City's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our test disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

The City's Responses to Findings

The City's responses to the findings identified in our audit are described in the accompanying Schedule of Findings and Recommendations. The City's responses were not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

Purpose of This Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the result of that testing, and not to provide an opinion on the effectiveness of the City's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the City's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.



CliftonLarsonAllen LLP

Brainerd, Minnesota
April 21, 2017

This Page Has Been Intentionally Left Blank.

**CITY OF PEQUOT LAKES, MINNESOTA
SCHEDULE OF FINDINGS AND RECOMMENDATIONS
YEAR ENDED DECEMBER 31, 2016**

MATERIAL WEAKNESS (FINANCIAL REPORTING)

2016-001 Annual Financial Reporting Under Generally Accepted Accounting Principles (GAAP)

Criteria: Management is responsible for establishing and maintaining internal controls and for the fair presentation of the financial statements including the related disclosures, in conformity with U.S. generally accepted accounting principles (GAAP).

Condition: The City does not have an internal control policy in place over annual financial reporting that would enable management to prepare its annual financial statements and related footnote disclosures, are complete, and presented in accordance with GAAP.

Context: Management has informed us that they do not have an internal control policy in place over the annual financial reporting and that they do not have the necessary staff capacity to prepare the annual financial statements including footnote disclosures.

Cause: The City relies on the audit firm to prepare the annual financial statements and related footnote disclosures. However, they have reviewed and approved the annual financial statements and the related footnote disclosures.

Effect: The potential exists that a material misstatement of the annual financial statements could occur and not be prevented or detected by the City's internal controls in the normal course of business.

Recommendation: Management should continue to evaluate their internal staff capacity to determine if an internal control policy over the annual financial reporting is beneficial.

Management Response: The City will continue to evaluate whether an internal control policy over financial reporting would be beneficial.

**CITY OF PEQUOT LAKES, MINNESOTA
SCHEDULE OF FINDINGS AND RECOMMENDATIONS (CONTINUED)
YEAR ENDED DECEMBER 31, 2016**

SIGNIFICANT DEFICIENCIES

2016-002 Segregation of Duties

Criteria: City management should constantly be aware of the need to have adequate segregation of duties regarding the processing of transactions for the City. In addition, City management should be aware that the concentration of duties and responsibilities in one or a very few individuals is not desirable from an internal control perspective.

Condition: Adequate segregation of the accounting functions necessary to ensure adequate internal accounting control, is not in place. The City has reassigned a number of the previously identified responsibilities, however, due to the number of employees available to assign responsibilities, some weaknesses still exist.

Context: Management has informed us the size and budget of the City limit the number of personnel performing these duties.

Cause: The City has a limited number of personnel.

Effect: The design of the internal controls over financial reporting could affect the ability of the City to record, process, summarize, and report financial data consistently with the assertions of management in the financial statements. In addition, this lack of segregation of duties may result in the City's inability to prevent/detect misappropriation of assets.

Recommendation: We recommend City management be aware of the lack of segregation of duties within the accounting functions and provide oversight to ensure the internal control policies and procedures are being implemented by City staff.

Management Response: The City will review the accounting functions and segregate them, if possible, with limited staff.

INDEPENDENT AUDITORS' REPORT ON MINNESOTA LEGAL COMPLIANCE

Honorable Mayor and
Members of the City Council
City of Pequot Lakes
Pequot Lakes, Minnesota

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the accompanying financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Pequot Lakes (the City), Minnesota, as of December 31, 2016, and the related notes to the financial statements, which collectively comprise the City's basic financial statements as listed in the table of contents and have issued our report thereon dated April 21, 2017.

The *Minnesota Legal Compliance Audit Guide for Cities*, promulgated by the State Auditor pursuant to Minnesota Statutes §6.65, contains seven main categories of compliance to be tested: contracting and bidding, deposits and investments, conflicts of interest, public indebtedness, claims and disbursements, miscellaneous provisions, and tax increment financing. Our audit considered all of the listed categories.

In connection with our audit, nothing came to our attention that caused us to believe that the City failed to comply with the provisions of the *Minnesota Legal Compliance Audit Guide for Cities*. However, our audit was not directed primarily toward obtaining knowledge of such noncompliance. Accordingly, had we performed additional procedures, other matters may have come to our attention regarding the City's noncompliance with the above referenced provisions.

The purpose of this report is solely to describe the scope of our testing of compliance and the results of that testing, and not to provide an opinion on compliance. Accordingly, this communication is not suitable for any other purpose.



CliftonLarsonAllen LLP

Brainerd, Minnesota
April 21, 2017